

Business finance ratios



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MEMORANDUM Riordan Manufacturing & Kuddler Fine Foods selected ratios and their significance is discussed below: Ratios Formula Riordan

Manufacturing

Kuddler Fine Foods

Current ratio

Current Assets/Current Liabilities

2. 087: 1

16. 94: 1

Debt ratio

Total Debt/Total Asset

36%

28%

Profit margin

Net Profit/Sales

3. 85%

6. 26%

Return on Assets

Net Profit/Assets

5. 65%

25. 29%

The average P/E

Current ratio is the most important measure of the short term liquidity of the organization. It indicates about the capability of the firm to pay off its short term liabilities with its short term assets. Ideally a ratio of 1: 1 is being considered good however in the case Riordon, the ratio is more than 2. However, it must also be noted that having higher current ratio can be

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detrimental to the overall financial health of the organization as too much resources will be engaged into non-productive use. In case of Kuddler Fine Foods, since the company is engaged into grocery business and sales mostly on cash therefore it has to carry higher inventories.

Debt ratios signify the use of debt in acquiring the assets of the company. It signifies how the company has financed its assets and through what combination of debt and equity. Riordan Manufacturing has a higher debt ratio as compared to Kuddler foods however it must also be noted that the use of higher debt may also be favorable for the firm as it allow them to magnify their P/E ratio due to the impact of debt on taxable income of the firm. Apart from that the higher debt will allow firms to get the tax benefits also. However it also must be noted that the higher debt may be risky as taking more debt means putting on more burden on the existing resources to pay back the debt rather than being channeled into the more productive resources.

Profit Margin is a ratio of great importance as it actually indicates what company is earning after paying off all its costs. This is in its essence is one of the key ratios of the success of the firm. In this regard, the profit margin of Riordan Manufacturing is less than that of the Kuddler Fine Foods. This can be because of the differences in their industry. Riordon being in manufacturing sectors has to incur costs which Kuddler, being in grocery business, may not incur. Further, the low profit margin for Riordon may also be attributed to its higher fixed costs ratio in its overall cost structure.

Return on Assets is another very critical indicator of the how efficient firm is in running and managing its resources. High asset turnover and return on assets clearly indicate the level of professionalism and management

approach. The ratio is significant in the sense that it provides management the vital indicator of how the firm is managing its assets to derive the sales. A low ratio would mean that it is taking more assets of the firm to generate the desired level of the return thus inefficient approach to managing the firm resources.