

# [Interpreting financial performance using a range of ratios](https://assignbuster.com/interpreting-financial-performance-using-a-range-of-ratios/)

Return on capital employed (ROCE) could be classed as one of the most important profitability ratios.

It works out the relationship between the capital and net profit earned. Investors will wish for the percentage to be higher than it would if they had money within in a savings account as they all wish to make more money. The formula to work the ROCE for Whitbread plc is as follows: Net profit after interestShareholders funds (Capital) X 100 = ROCE2001/2 76. 41888. 5 = 0.

04045 X 100 = 4. 05%2002/3 237. 11990. 6 = 0. 1191 X 100 = 11.

91 %By looking at the figures from Whitbread plc it is clear to see that there has been a large increase in the ROCE, from 4. 05% in 2001/2 to 11. 91% in 2002/3, it has more than doubled, and this means that every ï¿½10 invested in the business will earn Whitbread plc 4. 05p. This is good for a business to have such an increase in ROCE as they have improved dramatically from the year before.

Gross profit marginThis ratio shows the relationship between the figure earned through sales and the cost of sales. It shows the gross profit amount earned for every ï¿½100 worth of sales. Gross profit X 100 = Gross profit marginSalesThe calculation for Whitbread plc gross profit margin is as follows: 2001/2 466. 32014.

3 = 0. 23149 X 100 = 23. 15%2002/3 4411794. 1 = 0.

2358 X 100 = 24. 58%By looking at the figures for Whitbread plc it shows that in 2001/2 the gross profit margin percentage was 23. 15%, however in 2002/3 it has increased to 24. 58%, this could be due to such changes in aspects such as suppliers, or securing discounts for bulk.

Net profit marginThe net profit margin is showing the relationship between both the amount earned through sales and the total expenses of the business. The calculation will show how much net profit Whitbread plc make to every ï¿½100 earned. Net profitSales x 100 = net profit marginThe calculation for Whitbread plc would be as follows: 2001/2 76. 4 = 0. 0379 X 100 = 3.

79%2014. 32002/3 237. 11794. 1 = 0. 13215 X 100 = 13.

22These calculations show that Whitbread plc have increased there net profit margin by 9. 43% in the past year, this shows a good indication of Whitbread plc being able to control their level of expenses whilst increasing their sales at the same time, this would have increased the profitability of the business from the past year. Current ratioThe current ratio compares the current assets against the current liabilities and indicates whether the business has well enough short-term funds to meet their short-term liabilities. Current assetsCurrent liabilities =: 1The calculations for Whitbread plc are as follows: 2001/2 2002/3213.

2 230. 4431. 8 = 0. 49: 1 = 0.

49: 1474. 4In both 2001/2 and 2002/3 the figure for the current ratio is 0. 49: 1 , this is not good for a business, it may indicated such aspects as liquidity problems in the future for Whitbread plc and that they may have higher levels of short-term debt than they do funds. The ideal ratio for a business would be 2: 1, however it is now realised that there is not a ‘ best’ current ratio for a business. Acid test ratioThe purpose of this ratio is to see if a business has sufficient liquid funds to pay its immediate debts off, to do this ratio you deduct stock from the current assets as it is the least liquid.

Current assets- stockCurrent liabilitiesFor Whitbread plc it is as follows: 2001/2213. 2-28. 1 = 0. 4286 = 0.

43: 1431. 82002/3230. 4-23. 9474. 4 = 0.

43528 = 0. 44: 1In 2001/2 Whitbread plc had 4. 30 to every ï¿½10 of its immediate debts. In 2002/3 the figure shows a slight improvement by rising to ï¿½4. 40 to every ï¿½10 they owe in immediate debt.

Debtor collection periodDebtor collection period is the time it takes for a customer to pay back its debts to the business in hand. The average time for a business to give customers for paying debts of is 30 days, other businesses such as brokers, have a variety of payment choices such as end of month (EOM) or if there credit rating is low, they may not have the right to have credit at all. Debtors X 365 days = total amount of days it takes to payCredit sales2001/21122014. 3 X 365 = 20. 29 = 20 Days2002/3131.

11794. 1 X 365 = 26. 67 = 27 daysBy the above figures you can see that the debtors is not looking good for Whitbread plc, their debtors has increased from ï¿½112 million, to ï¿½131. 1 million. Also the amount of days it takes for debtors to pay back has also risen to 27 days from the 20 days the year before.

To fix this, Whitbread plc needs to look at the effectiveness of their credit control system and accounts department. Although financially Whitbread plc may seem to be stable, aspects such as debtors can dramatically affect future profits for the business. Credit collection periodCreditors are the opposite to debtors, these are the people/businesses which Whitbread plc owe money to. However for Whitbread plc their accounts do not contain the information needed to work out this ratio, however the calculation is as follows: CreditorsCredit purchases X 365 days = days taken to payStock turnoverThis calculation shows how many times a product is used and how often stock is turned around. This is a good way for a analysis to take place of what stock is being used and how well its doing. If stock is shown to reduce, this may be caused to a slowing down of trade.

Cost of salesAverage stock = Number of times2001/2154828. 1 = 55. 09 = 56 times2002/31353. 123. 9 = 56.

62 = 57 timesThis shows a slight increase in stock turn over from the figures above for Whitbread plc. Also it shows that they have been trying to decrease the amount of stock it holds and the cost of the sales. Analysis of financial healthHaving looked over the figures for Whitbread plc I feel the business is growing at a decent rate. The return on capital employed increased dramatically from 2001 – 2003, with a rise of 7. 86%, this is good news for investors as they will get a substantial amount back in return for what ever amount invested. The gross profit margin has risen slightly by 1.

43%, this indicates that’s Whitbread plc have been able to control its cost of sales compared to its increase in sale which was around 11%. Factors which could have caused this may have been that Whitbread plc has found a cheaper supplier, or ordering stock in higher levels of bulk, lowering the individual unit cost of certain products. The net profit margin has increased the most out of all of the figures i have seen for Whitbread plc; with a rise of 9. 43% Whitbread plc must have taken a stricter control over its expenses as business. Improvements that I would recommend for Whitbread plc would to take more notice on their debtors, this can effect the overall profitability of the business as the average amount of time to pay back has risen to 27 days, also the amount for debtors has risen by ï¿½19.

1M, this is a large amount which, if a sufficient credit control system was in place, could be amended. If this was to be done, Whitbread plc will notice a healthier cash flow for the future.