

73.2 An exercise on profit ratios

The figures given in question 73.1 are now supplemented for companies A and B with figures from the published accounts of the prior year.

For each company separately, calculate and compare the same ratios as above for the current year and the prior year. Comment on any differences you may find, from one year to the next.

A.

pharmaceutical	current year	prior year	RATIOS	current year	prior year
Sales	26 475	23 950			
Cost of Sales	(5 559)	(5 356)			
Gross Profit	<u>20 916</u>	<u>18 594</u>	Gross Profit Ratio	79.0%	77.6%
profit before tax	<u>8 543</u>	<u>6 667</u>	Net Profit Ratio	32.3%	27.8%
equity	<u>15 416</u>	<u>13 691</u>	activity ratio sales/equity	1.72	1.75
current debt	<u>136</u>	<u>90</u>			
long-term debt	<u>1 087</u>	<u>1 111</u>	activity ratio sales/capital employed	1.59	1.61
total debt	<u>1 223</u>	<u>1 201</u>			
capital employed	<u>16 639</u>	<u>14 892</u>			

Comment

In the current year, A has reported a small increase in its already high gross profit margin, and a larger increase in its net profit margin, indicating an improvement in A's trading position or competitive power, coupled with some degree of cost reduction (whether this indicates greater efficiency or merely a cut in research and development expenditure would need to be investigated). At the same time, A's activity ratios indicate that although making more profit on each sale, the company has somewhat slowed down its rate of making sales.

B.

supermarket	current year	prior year	RATIOS	current year	prior year
Sales	39 454	33 866			
Cost of Sales	(36 426)	(31 231)			
Gross Profit	<u>3 028</u>	<u>2 635</u>	Gross Profit Ratio	7.7%	7.8%
profit before tax	<u>2 235</u>	<u>1 894</u>	Net Profit Ratio	5.7%	5.6%
equity	9 444	8 654	activity ratio		
current debt	1 646	482	sales/equity	4.18	3.91
long-term debt	3 742	4 563			
total debt	<u>5 388</u>	<u>5 045</u>	activity ratio		
capital employed	<u>14 832</u>	<u>13 699</u>	sales/capital employed	2.66	2.47

Comment

B's gross and net profit ratios show no great changes from prior year to current year (a tiny decrease in gross profit margin, coupled with an equally tiny increase in net profit ratio). If such small movements are at all significant, they would tend to indicate more competitive trading, and greater efficiency. Changes in B's activity ratios are somewhat larger and possibly more significant – they indicate that the firm has made its assets and its shareholders' investment work harder in the current year than in the previous year.