

### 70.1 A drill to practise use of the gearing ratio

Below are extracts from the published accounts of two listed companies. One is a producer of luxury goods, the other owns and operates an electricity distribution network.

Calculate gearing ratios for each company, and state, with reasons, your opinion as to which is which.

	A	B
<b>EQUITY</b>	4 136	11 868
<b>BORROWINGS</b>		
current	1 025	3 376
non-current	14 686	4 443

#### Response

Workings for the gearing ratios are shown below:

	A	B
<b>EQUITY</b>	<u>4 136</u>	<u>11 868</u>
<b>BORROWINGS</b>		
current	1 025	3 376
non-current	<u>14 686</u>	<u>4 443</u>
	<u>15 711</u>	<u>7 819</u>
<b>EQUITY+DEBT</b>	<u><u>19 847</u></u>	<u><u>19 687</u></u>
debt:equity	$\frac{15\,711}{4\,136}$	$\frac{7\,819}{11\,868}$
	=	=
gearing	3.8	65.9%
debt:equity+debt	$\frac{15\,711}{19\,847}$	$\frac{7\,819}{19\,687}$
	=	=
gearing	79.2%	39.7%

Company A has very high gearing and is therefore most probably the owner/operator of the electricity distribution network. Such a company, with an extensive fixed asset base, would be able and likely to finance itself with borrowings to a far greater extent than a luxury goods company – which must be represented by Company B.