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B.Com Honours | Semester III | Calicut University

FINANCIAL STATEMENT ANALYSIS

Course Code: COM3MN204 • Module 2 Notes

Module II: Ratio Analysis

Ratio analysis is the quantitative benchmark tool expressing structural relationships between financial statement line items to diagnose liquidity, efficiency, leverage, and profitability.

Unit 5: Ratio Analysis – Meaning, Objectives, Utility, & Limitations

A mathematical relationship between two financial figures expressed as a pure ratio, percentage, or times. **Objectives & Utility:** Measuring operational efficiency, identifying financial trends, enabling peer benchmarking, and detecting insolvency risks.

Unit 6: Classification of Ratios – Liquidity & Profitability Ratios

1. Liquidity Ratios:

> **Current Ratio = Current Assets / Current Liabilities**

> **Quick Ratio (Acid-Test) = (Current Assets - Inventory - Prepaid Expenses) / Current Liabilities**

2. Profitability Ratios:

> **Gross Profit Ratio = (Gross Profit / Net Revenue from Operations) × 100**

> **ROCE = (Net Operating Profit Before Interest & Tax / Capital Employed) × 100**

Unit 7: Turnover Ratios – Inventory, Receivables, & Operational Efficiency

Measure asset utilization speed:

> **Inventory Turnover Ratio (ITR) = Cost of Goods Sold / Average Inventory**

> **Debtors Turnover Ratio (DTR) = Net Credit Revenue / Average Trade Receivables**

> **Average Collection Period (Days) = 365 / Debtors Turnover Ratio**

Unit 8: Leverage Ratios – Debt-to-Equity & Interest Coverage Ratio

Measure capital structure solvency risk:

> **Debt-Equity Ratio = Total Debt / Shareholders' Funds**

> **Interest Coverage Ratio = EBIT / Annual Fixed Interest Expense**

Practical Problem 2 (Comprehensive Solved Ratio Problem): From the following details of Apex Corporation, calculate (a) Current Ratio, (b) Quick Ratio, (c) Inventory Turnover Ratio, (d) Debtors Turnover Ratio & Collection Period (in days), and (e) Debt-Equity Ratio:
Cost of Goods Sold = Rs. 24,00,000; Net Credit Revenue = Rs. 36,00,000. Opening Inventory = Rs. 3,50,00,000;

Closing Inventory = Rs. 4,50,00,000. Trade Receivables = Rs. 6,00,000; Current Assets = Rs. 12,00,000. Current Liabilities = Rs. 6,00,00,000; Total Long-Term Debt = Rs. 10,00,00,000; Share Capital + Reserves = Rs. 20,00,00,000.

Step-by-Step Solved Calculations:

- *(a) Current Ratio:* (12,00,000 / 6,00,00,000 = mathbf{2.0:1}).
- *(b) Quick Ratio:* Quick Assets = Current Assets (12,00,000) - Inventory (4,50,00,000) = Rs. 7,50,000. Quick Ratio = (7,50,000 / 6,00,00,000 = mathbf{1.25:1}).
- *(c) Inventory Turnover Ratio:* Average Inventory = ((3,50,00,000 + 4,50,00,000) / 2 = ext{Rs. 4,00,00,000}).

  > **ITR = COGS (24,00,000) / Average Inventory (4,00,00,000) = 6.0 Times**

- *(d) Debtors Turnover Ratio & Collection Period:*
  DTR = Credit Revenue (36,00,000) / Debtors (6,00,000) = **6.0 Times**.

  > **Average Collection Period = 365 / 6.0 = 60.83 Days (~ 61 Days)**

- *(e) Debt-Equity Ratio:* Debt (10,00,00,000) / Equity (20,00,00,000) = **0.50:1** (Strong solvency balance).