*Ratio Analysis appears as Q.5. on the exam every year*.

These templates will provide the correct layout needed to achieve full marks for each of the 2 possible part B’s:

1. Ordinary Shareholder // potential share purchaser.
2. Debenture holder // Bank Manager.

**General // Understanding the template:**

- It is important that when you’re studying/practicing accounts, you should keep everything as simple and easy as possible. This is a general rule which these templates will follow so it’s important that you can follow these.

You need to be aware of something I made up when I was in sixth year. I call this “The three C’s”:

**Calculate – Comment – Compare!!!!**

You need to use the 3 C’s for every figure that you write down.

1. **Calculate:** You must first calculate the figure for the year in question, this is the obvious one. Make sure to show all calculations clearly, in part a **AND** in part b. This is important.

2. **Comment:** You need to have at least one point to summarise what exactly that figure means. i.e. Gearing = 45%. Now comment on this. Comment – The company is lowly geared. This is a positive thing. Etc.
3. **Compare:** After you have commented on the figure, you must now relate the figure back to the previous years corresponding figure and comment on the *nature and meaning* of the trend. Sometimes last year’s figure is one you calculated in part a or sometimes it might require a whole new calculation. If it is one from part a and you think you got it wrong, continue anyway as you will not be deducted marks again for using your own figure.

i.e. Gearing last year = 55%. This shows a positive trend. Gearing has improved by 10%. The company has moved from a vulnerable position to a safer one. *If gearing is less than 50% this is a good thing*.

- Remember, as much as I don’t want to say this, question 5. is not actually guaranteed on the exam but has been on it every year so you can almost count on it.
- Now that you know what to do with each figure, you will be able to follow the template. i.e. If you see “Dividend Cover”, by itself in the sample, it doesn’t mean that you write down “Dividend cover”, and move on. It means that you write down “Dividend cover”, you calculate the dividend cover, you comment on its meaning and then compare it to last year.
- This must be followed throughout the question since every question will have a different explanation. (i.e. one might improve from one year to the next and one might deteriorate etc.
- The reason I created these templates this way is because so many people panic and rule out Q.5, as soon as they see it because it does look quite daunting the first time you see a full solution after just doing pure accounts up until then. Also, some people deliberately dropped leaving cert business to avoid this type of question so having a simplified version to start with always helps.
- Another thing to keep in note is that you may not always be comparing to last year’s figures. In 2012, students had to compare forward. The only thing that changes in this situation is the language you use.
  i.e. Instead of “This was 10% better than last year”, you would say “This is expected to rise by “10% by next year”.
- Remember that you only have about 45 mins to complete this question overall so you really do need to write quick, much like the English exam. Unless you’re magic, you
will be under time pressure, but don’t panic. This is why you should leave this question until last and spend all of your remaining time on it. Know your formulas inside out as well to save time.

- Finally, don’t think you have to do this question on the day just because it’s a guaranteed (almost) question. I spent so much time learning this like the back of my own hand but ended up not doing it because the Cash Flow and Club a/c in my exam were too nice to pass on.
- When starting off practicing these questions, try to do one without looking for every three you do with the template. This is how you will improve faster.
- Finally, anything in this grey colour is relevant to specifications in the question.

**Formulae:**

- At higher level there are about 23-25 formulae that must be learned off by heart before attempting this question. They are needed for all of part a and parts of part b and occasionally even part c.
- The slant symbol (/) in this case means “divided by”, and all figures in brackets should be calculated first. i.e. (4+2)/3 = 2.

**List of formulae:**

- **Return on Capital Employed:**
  
  \[
  \frac{\text{(net profit + interest)} \times 100}{\text{Capital employed.}} \text{ (%)}
  \]

- **Return on shareholders’ equity funds:**
  
  \[
  \frac{\text{(net profit-preference dividends)} \times 100}{\text{Shareholders funds.}} \text{ (%)}
  \]

- **Shareholders’ funds:**
  
  Ordinary shares + P and L balance.

- **Gross profit mark up:**
  
  \[
  \frac{\text{(Gross profit} \times 100)}{\text{Cost of sales}} \text{ (%)}
  \]

- **Gross profit margin:**
  
  \[
  \frac{\text{(Gross profit} \times 100)}{\text{sales.}} \text{ (%)}
  \]

- **Net profit %:**
(Net profit x 100)/Sales (%)  
- **Current ratio:**
  Current assets: Current liabilities  (x : y)
- **Acid/quick/liquid ratio:**
  (Current assets – Closing stock): Current liabilities.  (x : y)
- **Average stock:**
  (opening stock + closing stock)/2 (€)
- **Average period given to debtors:**
  (Trade debtors x 12)/Credit sales (Months)
- **Average period received from creditors:**
  (Trade creditors x 12)/Credit purchases. (Months)
- **Gearing:**
  [(debentures + preference shares) x 100]/Capital employed. (%)
- **Interest cover:**
  (Net profit + interest)/Interest (Times)
- **EPS:**
  [[(Net profit – Preference dividends) x 100]/Ordinary shares. (Cent)
- **P/E ratio:**
  Market price/EPS (Years)
- **DPS:**
  (Ordinary dividends x 100)/Ordinary shares (Cent)
- **Dividend Cover:**
  (Net profit – Preference dividends)/Ordinary Dividends (Times)
  OR:
  EPS/DPS (Times)
- **Dividend yield:**
  (DPS x 100)/Market price (%)
- **Period to recover shares at present payout:**
  Market price/DPS (Years)
- **Period to recover shares at present earnings/performance:**
  Market price/EPS (Years)
- **Cash purchases:**
  Total purchases – Credit purchases (€)
- **Total purchases:**
  Cost of sales + closing stock – Opening stock (€)
- **Cash Sales:**
  Total sales – Credit Sales (€)
- **% Profits paid out to shareholders = 100/Dividend cover.**

**Ordinary shareholder/Potential share purchaser:**

**Performance:**

Profitability:
- Profitable business (If they have a retained profit)
- Return on Capital Employed (Above/Below risk-free investment and company’s cost of borrowing (debentures)).
  - Earning x% on capital employed but spending y% of this investment on €z debentures.
- ROCE increase = More efficient use of resources than last year and vice-versa.
- If my friend buys shares at (90 cent) it will take [(90)/DPS] years to recover them at present payout.

**Dividend Policy:**
- DPS.
- Dividend cover (increase = more profits retained).
- Dividend yield (Above/below risk free and cost of borrowing).
- % profits paid out ((Not) Pleased that enough profits are being retained to repay debenture holders).
- Based on this year's net profit of €x, ordinary dividends of €y are excessive /okay.
  ➢ i.e. if net profit was €33,000 and ordinary dividends were €27,000, this would be excessive. If the net profit was €108,000 and ordinary dividends were €15,000 this would be okay.
- Interest of € (Shares x share price – own investment) is €x. The € (Shared x DPS) income available from dividends seem favourable.

**State of Affairs:**

**Liquidity:**
- The company has good liquidity/a liquidity problem.
- Working capital (current) ratio.
- Quick ratio.
  ➢ Above/Below the ideal 1:1.
- May (not) have problems paying debts as they fall due.
- They have €x available for every €1 owed in the short term.
- Good liquidity = ability to pay interest + dividends
  OR:
  Bad liquidity = worried purchaser. Risk of not being able to pay dividend even if the company is profitable.

**Gearing:**
- The company is highly/lowly geared (above/below 50%)
- Gearing
  ➢ Improvement (the lower the better) = Not dependent on outside borrowing and outside investors now have less control than last year. (Opposite for deterioration).
  ➢ Improvement = Greater chance of getting a dividend and easier for the business to make interest and dividend payments.
- Interest cover.
➢ Improvement = No problem paying interest charges & good for potential share purchaser.

**Investment policy:**
- Investments made by the company which cost €x now have a market value of €y. This is an increase/decrease of z%.
- Increase/decrease shows good/poor management of resources and investment decisions by management.
- Investments could be used to repay debentures next year but shareholders might not be impressed with this as it would have a negative effect on them.

**Prospects:**

**Market value of a share:**
- Market value
  ➢ Increase = market confidence = good.
  - Shareholders pleased that the market value of a share is increasing as they would now gain more money if they wanted to sell their shares & opposite for decrease.
- EPS.
- P/E ratio
  ➢ Shorter time = possibly more appealing to shareholders if they’re looking for a quicker return on investment (shorter = less time to recover investment per share).

**Sector:**

*This list was created as of 2019. This section will always change throughout the years and you should ask your teacher for advice here.

The following list can be adapted to suit most industries (as of 2019).

- The company operates in the (see top of question) industry.
- The economy is currently reasonably stable.
- People generally have more take home pay now than a few years ago.
- Access to credit (loans) is easier now than before.
- Brexit brings a level of uncertainty.
- The industry is capable of growing.

Debenture holder/Bank manager:

Performance:

Profitability:
- The business is profitable (if they have a retained profit).
- Return on capital employed
  ➢ Increase = more efficient use of resources than last year.
  ➢ Above/below risk free/cost of borrowing (debentures)/Loan (ln Q).
- The company is earning x% on capital employed and only paying y% on €z debentures. This is (not) good. There is (no) risk of having to sell some fixed assets in order to repay debentures.
- EPS
  ➢ Increase = Good, no cause for return.
  ➢ Decrease = May have to sell some fixed assets to repay debenture holders, a cause for concern.

Dividend policy:
- Dividend cover
  ➢ Increase = More profits retained to repay debentures and future interest.
- % profits paid out.
  ➢ Enough profits are (not) being retained to pay off the loan.
Based on this year's net profit of €x, ordinary dividends of €y are excessive /okay.

➢ i.e. if net profit was €33,000 and ordinary dividends were €27,000, this would be excessive. If the net profit was €108,000 and ordinary dividends were €15,000 this would be okay.

**State of Affairs:**

**Liquidity:**
- The company has good liquidity/a liquidity problem.
- Working capital (current) ratio.
- Liquid/acid/quick ratio.

➢ Above/below the ideal 1:1
- May (not) have problems paying debts as they fall due.
- The company has €x for every €1 owed in the short term.
- Due to their good liquidity, if the loan is granted, the company can pay the interest of (loan x interest rate) & opposite for bad liquidity.

**Gearing:**
- The company is highly/lowly geared (above/below 50%).
- Gearing:

➢ Improvement (the lower the better) = Not dependent on outside borrowing and outside investors now have less control than last year. (Opposite for deterioration).

➢ Improvement = Easier for the business to make interest and dividend payments.
- Interest cover:

➢ Improvement = No problem paying interest charges.
- If the loan of €x is granted, gearing will improve/deteriorate to € (Use gearing formula here but add the amount of the loan to the top and the bottom).
Security:
- Debentures are secured on fixed assets of €x (not including financial fixed assets).
  ➢ €y are intangible, leaving €z net assets.
- Debenture holders would be interested in the size of the Fixed assets to ensure there is sufficient security.
- Debenture holders would feel secure since the fixed assets are over (4) times the loan of €x.
  ➢ If they got the loan it would add pressure but they would still be secure.
- The real value of the fixed assets is uncertain since there are no write offs like depreciation.
- Investments made by the company which cost €x now have a market value of €y.
  ➢ This indicates wise/poor investment decisions by management

Sector:

*This list was created as of 2019. This section will always change throughout the years and you should ask your teacher for advice here.

The following list can be adapted to suit most industries (as of 2019).

- The company operates in the (see top of question) industry.
  • The economy is currently reasonably stable.
  • People generally have more take home pay now than a few years ago.
  • Access to credit (loans) is easier now than before.
  • Brexit brings a level of uncertainty.
  • The industry is capable of growing.
Writing your interpretation as a report:

- Sometimes you can be asked to give your answer in the form of a report. The best example for this is the 2015 exam.
- In this case you split your answer up into 3 different parts rather than just one bulk answer.

1. Before your interpretation you should include the following:

   Advice concerning (now mention whatever it says in the question)

   To: In question.
   From: In question.
   Date: Date of exam.

2. Now write your main body as normal using one of the templates from the pages above.

3. After your interpretation you should include the following:

   Recommendations/advice/conclusions:
   - I would advise you to/not to (now mention the specifications in the question).

   Signature: (Sign your name here).
List of Sectors to practice from previous questions:

- ... Manufactures in sports and fitness equipment
- Pharmaceutical industry
- Sportswear industry
- Construction industry
- Health and food manufacturer
- Tourist industry
- Print/Stationary industry
- A manufacturer in the food processing sector
- ... involved in the importing of gardening furniture
- A company that produces tinned foods from the agricultural sector
- A manufacturer in the renewable energy industry
- A company that runs a chain of hotels
- A manufacturer in the dairy industry
- A manufacturer of building materials
- A manufacturer in the clothes business
- Soft drinks industry