

Name: \_\_\_\_\_

Date: \_\_\_\_\_

## Ratio Analysis – Ch. 9

**Ratio analysis** – evaluates the relationship between various amounts within the financial statements.

**Return on Sales:** evaluates the company's profitability during the accounting period. Shows the portion of each revenue dollar that represents profit.

$$\frac{\text{Net Income}}{\text{Total Revenue (Sales)}} = \text{Return on Sales}$$

Example:

**Liquidity** - the ability of people to get into and out of investments. A liquid asset is one that you can buy and sell easily and quickly.

- **Example:** a bank account is very liquid because you can go to the bank and take your money out quickly and easily.
- **Example:** equipment is less liquid because you would need to find a buyer willing to pay you for the value of the equipment. This may take weeks or even months before you receive the money.

**More Liquid** = Cash

**Less Liquid** = Equipment



**Current Assets** – used up or converted to cash during the normal operating cycle of the business.

**Current Liabilities** – must be paid within the next accounting period.

**Current Ratio:** measures a company's ability to meet its current financial obligations by dividing its current assets (such as cash, accounts receivable, etc.) by its current liabilities.

The current ratio is a good way to determine a company's current financial health. If a company's current ratio is low, the company may have to default on its debt in the near future. When that happens, the company will go bankrupt.

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \text{Current Ratio}$$

Example:

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### **Group Instructions**

1. As a group, choose four pairs of companies from different industries. The pairs of companies must be a company and its direct competitor (example: Target & Wal-Mart).
2. Use <http://finance.yahoo.com> to find the Income Statement and Balance Sheet for each of the companies.
3. Calculate Return on Sales for each company using the information from the past three years. Use Excel to do your calculations!
4. Calculate the Current Ratio for each company using the information from the past three years. Use Excel to do your calculations!
5. Check to be sure that you have clearly labeled each calculation.
6. Once you have finished these calculations, each group member must write a short explanation for his/her two companies, describing whether the company's ratios improved or declined over the three years and why this information is important to these companies. What do these ratios mean? (approx. ½ page each)
7. As a group, put the eight companies into two lists. Order the companies from strongest to weakest in each list, based first on the return on sales ratio and then on the current ratio.
8. Work together as a group to analyze your research and draw conclusions about the particular industries you looked at. For instance, which industry has the highest average return on sales? Which has the lowest? What does this tell you about those particular industries? Are there differences or similarities among particular industries? (approx. 1 page)
9. Compile all of your group's work and staple it together. Be sure each group member's name is on the document before turning it in for credit.