RATIO ANALYSIS

Table of Contents

Introduction

Financial statement analysis is required to be considered as one of the most important part of financial decision making as the comparative analysis facilitates the financial managers in identifying the most appropriate investment option. In this study, the researcher shall make discussion by considering Ark Resources Berhad and Ahmad Zaki Resources Berhad. In this context, the researcher is required to mention that both the companies belong to construction industry. Ark Resources Berhad has started its operation as a specialist in the soil improvement sector. In this context, the researcher is to mention that the company has been established in 1983 as Ark group of companies. After that, the company has changed its name in August 2006 due to the conversion of the company into a limited company. The vision of the company is *"to be globally recognized Malaysian engineering and construction group with a reputation for technical and delivery excellence"*. On the other hand, the mission of the company is to implement the most appropriate operational practices in the construction industry. Moreover, the company is also required to serve meet the customers demand, as this factor is included in the mission of the company (Klse.i3investor.com. 2017). This company makes its operation in the Malaysian market only.

On the other hand, the researcher is required to mention that the business of Ahmad Zaki Resources Berhad has started its business on May 1997. The company has a global business structure as the company operates its business in the Malaysian market as well as in the market of Singapore. In this context, the researcher is required to mention that the company has the vision to be *"the trusted leader in the industry in delivering commitment with excellence and value"*. On the other hand, the vision of the company includes pro-active research, partnership with stakeholders like customers and the employees and setting high industry standard (azrb. 2017).

Explanation of liquidity ratios and the profitability ratios

Liquid ratios

The use of liquidity ratios is required to be considered as a way of analyzing the ability of meeting the short-term obligations of a company. The liquidity ratios of a company define the ability of company in paying off the current debts in terms of numerical figures. Therefore, it can be said that the researchers or analysts could identify the most solvent firms by considering the liquid ratios. In this context, Sulaiman *et al.* (2016) opined that the current ratio, liquid ratio and cash ration are required to be identified as the basic liquid ratios as these ratios helps the researchers to disclose liquidity positions of a profit seeking concerns. In this contrary, Saat *et al.* (2016) argued that working capital is required to be identified as the most important liquidity parameter and therefore, the comparison of liquidity position is to be made by considering the working capital ratio. The discussion on the liquidity ratios with explanation could be made as follow.

Current ratio:

The current ratio could be computed by considering the formula below.

Formula:

Current ratio = Current assets / Current liabilities

Explanation:

In the above formula, Current assets = Inventory + Cash and cash equivalent + Trade receivables + Prepaid expenses.

Current liabilities = Trade payables + Outstanding expenses + Bank overdraft.

From the above information, it can be said that the current ratio defines the value of current assets per unit of current liability. As cited by Salleh *et al.* (2016), the comparison of liquidity positions of different companies could be made easily by considering the current ratio as all the current assets and liabilities are considered in this special ratio.

Usefulness:

As the current ratio considers all the relevant current assets and liabilities of a company, the researcher could mention that the current ratio reflects the most appropriate liquidity position of a company. On the other hand, the researcher could mention that the current ratio defines the value of current liability per unit of current asset, and therefore the creditors and debtors of the companies could get the facility to analyze the liquidly position of the company.

Liquid ratio or quick ratio:

Formula:

Liquid ratio = (Current assets – inventory – prepaid expenses) / (Current liabilities – Bank overdraft)

Explanation:

Liquid ratio could be defined as an important tool to identify the absolute liquidity position of a company (Abdullah, *et al.* 2016). Therefore, the computation of liquid ratio considers the items, which are not absolute liquid in nature. Therefore, inventory and bank overdrafts are deducted from current assets and current liabilities respectively.

Usefulness:

The liquid ratio helps the analysts to identify the absolute liquid position. In this context Yusoff *et al.* (2016), stated that the liquid ratio considers the current assets and liabilities, which are easily convertible into liquid cash. Therefore, the creditors could get the facility of selecting the vendors, which have the liquid cash.

Cash ratio:

Formula:

Cash ratio = Cash and cash equivalent / Current liabilities

Explanation:

In the cash ratio, the cash and cash equivalent are considered as numerator. In the cash and cash equivalent, cash balances, bank balances and the marketable securities are accounted. On the other hand, the current liabilities are considered as denominator in the formula of the cash ratio.

Usefulness:

The cash ratio could be useful to compute the ratio of liquid cash and bank balances and the current assets. In this context, it is to mention that the higher the cash ratio, better the portion of cash within the company.

Profitability ratios

In the profitability ratios, the researcher is to consider the gross profit and net profit ratios as the bases of analysis as these ratios reflects the total profitability and the net profitability of a company in terms of sales. As cited by Sulaiman *et al.* (2015), operating ratio is also required to be considered as an important aspect of profitability analysis as this ratio reflects the trading profit earning ability of a company. The profitability ratios are discussed below.

Gross profit ratio:

Formula:

Gross profit ratio = Gross profit / Net sales *100

Explanation:

In the gross profit ratio, the gross profit as calculated by deducting the cost of goods sold from the net sales is taken as numerator. On the other hand, the net sales of a company in considered as denominator in computing net profit ratio. Therefore, it can be said that the gross profit ratio defines the ratio of gross profit that a company makes and the net sales. In this context, it is also required to be mention that the higher gross profits means high profitability of a company in terms of trading practices (Ismail and King, 2014).

Usefulness:

As opined by Sulaiman *et al.* (2015), gross profit ratio helps the financial statement analysts to determine the trading profitability of a company as this ratio computes the gross earning capacity of a company. Therefore, the ratio is crucial for the financial managers to identify the loopholes in the performance of a company. On the other hand, Saat *et al.* (2016) opposed and opined that the gross profit ratio is one of the most important ratios for the investors As this ratio reflects the company's trading performance.

Net profit ratio:

Formula:

Net profit ratio = Net profit / Net sales *100.

Explanation:

The researcher is required to mention that the net profit could be determined by deducting the indirect expenses and by adding the non-operating incomes of the company. Therefore, it can be said that the net profit ratio discloses the overall profitability of a company.

Usefulness:

As mentioned in the above part of the study, net profit ratio helps the researchers to compute the overall profitability of a company. In this context, Najeeb and Ibrahim (2014) cited that the net profit ratio helps the investors and the managers of a company to identify the loopholes in the manufacturing or trading process. The investors could get the facility of choosing profitable investment option by considering the net profit ratio as a comparison tool. In this context, it is to mention that the companies with higher net profit ratio are required to be selected as investment option as higher net profit implies higher earning capacity.

Operating profit ratio:

Formula:

Operating profit ratio = Operating profit / Net sales *100.

Explanation:

In the above ratio, the operating profit could be calculated by considering the operating income and the operating expenses of a company. In this regard, the researcher is to mention that the operating profit of a company equals to net sales as deducted by operating expenses. In this context, the researcher is required to mention that the operating expenses could be calculated as follows.

Operating cost = Cost of goods sold + Office and administration expenses + Selling and distribution expenses.

Usefulness:

Operating profit is to be defined as the net result of a business operation. In this context,) stated that the operating profit ratio of a company reflects the earning capability of a company in terms of operations. Therefore, the management to identify the operating profitability and to make comparison of the net profit and net profit uses the operating profit ratio. Investors also find this ratio as important as this ratio could help the investors to identify the profit of the company out of the operating activity.

Computation and interpretation of liquidation ratios and the profitability ratios Ark Resources Berhad

Computation of liquidity ratios of Ark Resources Berhad			
Particulars	2013 (RM)	2014 (RM)	2015 (RM)
Current assets			
Cash and cash equivalent	2565216	887305	461928
Accounts receivables	3913471	5061771	13743227
Amount due from contract customers	8808163	2871848	1282538
Amount due from subsidiaries	-	-	-
Non-trade receivables and deposits	630617	839277	407591
Total current assets	15917467	9660201	15895284
Current liabilities			
Trade payables	4346330	5526395	4036695
Non-trade payables and accruals	674003	817052	1024834
Total current liabilities	5020333	6343447	5061529
Current ratio	**3.1705998**	**1.522863**	**3.1404115**
Liquid ratio	**1.4161021**	**1.0701363**	**2.8870221**
Cash ratio	**0.5109653**	**0.1398774**	**0.0912625**
Computation of profitability ratios			
Particulars	2013 (RM)	2014 (RM)	2015 (RM)
Sales	9154459	7400041	17496643
Gross profit	2464539	2093452	3604170
Net profit	123057	-194854	734432
Operating profit	594488	185399	1018068

Gross profit ratio	**26.921733**	**28.289735**	**20.599209**
Net profit ratio	**1.3442302**	**-2.633148**	**4.1975595**
Operating profit ratio	**6.493972**	**2.505378**	**5.8186476**

Table 1: Ratio analysis of Ark Resources Berhad

(Source: As created by the researcher)

In the above table (Table 1), the researcher has computed the liquidity ratios and the profitability ratios. While making the computation, the researcher has found that the company has fluctuated in 2014 from 3.2 to 1.5. After that period, the ratio has slightly improved and the ratio becomes 3.14:1. In this context, the researcher is required to mention that as the current ratio of the company for 2013 and 2015 were higher than the standard ratio 2:1, the liquidity position of the company could be considered as good. On the other hand, the liquid ratio of the company was above the standard level of 1:1, which is also a good sign for the manufacturing companies. The cash ratio has also showed a decreasing trend and therefore, the liquidity position of the company in terms of absolute liquidity is to be considered poorer as compared to the overall liquidity.

On the other hand, the profitability of the company in terms of gross profit could be considered as higher than the net profit ratio. In this context, the researcher is required to mention that the net profit ratio of the company has been recovered after making a net loss in 2014. In this context, the researcher is to mention that the negative net profit result caused negative impact on the operating result of the company and therefore, the company earned a operating profit at the rate of 2.5% in 2014.

Computation and interpretation of liquidation ratios and the profitability ratios of Ahmad Zaki Resources Berhad

Computation of liquidity ratios of Ahmad Zaki Resources Berhad			
Particulars	2013 (RM)	2014 (RM)	2015 (RM)
Current assets			
Cash and cash equivalent	102840044	132005159	153096147
Accounts receivables	450548485	660710453	1036818228
Current tax assets	4771079	6519134	8857544

Inventories	12314854	13176419	1449817
Property development costs	11994798	11942888	23473394
Total current assets	582469260	824354053	1223695130
Current liabilities			
Trade payables	304451913	325954004	457440597
Loans and borrowings	60724745	82756885	159148935
Current tax liabilities	11321928	5345532	5159505
Trade and other payables	304451913	325954004	457440597
Total current liabilities	680950499	740010425	1079189634
Current ratio	**0.855376802**	**1.11397627**	**1.133901857**
Liquid ratio	**0.848370303**	**1.105166754**	**1.125694269**
Cash ratio	**0.151024258**	**0.178382837**	**0.141862136**
Computation of profitability ratios			
Particulars	2013 (RM)	2014 (RM)	2015 (RM)
Sales	594233380	662358562	714972361
Gross profit	102885510	114515207	126653843
Net profit	5403208	12256546	21579473
Operating profit	36281257	43526942	72821701
Gross profit ratio	**17.31399034**	**17.28900532**	**17.71450897**
Net profit ratio	**0.909273727**	**1.850439732**	**3.018224784**
Operating profit ratio	**6.105556877**	**6.571507413**	**10.18524701**

Table 2: Ratio analysis of Ahmad Zaki Resources Berhad

(Source: As created by the researcher)

In case of Ahmad Zaki Resources Berhad, the liquidity position of the company has improved as the current ratio of the company has increased from 0.86:1 in 2013 to 1.13:1 in 2015. Moreover, the liquid ratio of the company has also increased due to the factor of increasing trend in the current ratio (Adibah *et al.* 2016). In this context, the cash ratio has decreased slightly in 2015. As the current ratio and the liquid ratio of the company has increased, the minor decrease in the cash ratio could be ignored as the current and the liquid ratio are considered as crucial parameters.

In case of the profitability ratios of the company, gross profit, net profit and the operating profit ratios have been seen as increased from 2013 to 2015. Therefore, it can be interpreted that the company had performed well in the three-year period of research.

Comparison of the companies' liquidity position and performances

Similarities and differences of performance and liquidity

From the discussion made above, the researcher could mention that both the companies have similar type of operation standard, as the companies are involved in construction industry. In this context, the researcher is also to state that the cash ratios of both the companies have declined during 2013 to 2015. On the other hand, the operating profit ratio and the net profit ratio of the company reflect positive results. The positive gross and net profit ratio is to be considered as the most impactful similarity between the two companies.

If the discussion is to be made on the differences of the performances and the liquidity positions of the companies, it could be mentioned that Ark Resources Berhad has a fluctuating trend in liquidity ratios, whereas the liquidity ratios of Ahmad Zaki Resources Berhad is fluctuating in nature. In case of the performance of the Ahmad Zaki Resources Berhad, it could be seen that the overall profitability of the company has been positive throughout the three year ended on 2015. On the other hand, the net profit ratio of Ark Resources Berhad in 2013 was negative.

Three factors influencing the liquidity position and performance

1. **Inventory:**

Ark Resources Berhad has no inventory in the current assets of the company and therefore, it can be said that the liquidity position of the company is different from Ahmad Zaki Resources Berhad could be due to the existence of inventory in the balance sheet of Ark Resources Berhad.

2. **Cost of goods sold:**

Cost of goods sold in Ark Resources Berhad has been seen as consistently higher than Ahmad Zaki Resources Berhad. Therefore, the net loss could be considered as the result of such higher amount of cost of goods sold.

3. **Finance cost:**

As the finance cost of Ahmad Zaki Resources Berhad is lower than the finanace cost of Ark Resources Berhad, the operating profit of the company has been seen as higher than Ark Resources Berhad.

Summary

In the study, the researcher has seen that the two companies in same industry could have difference in perfortmance as Ark Resources Berhad has no stock in hand but the other firm has a large amount of inventory in balance sheet. Current ratio has been defined as the parameter that reflects the ability of a company to repay its current liabilities. In this context, the researcher is required to mention that the current ratio of Ark Resources Berhad has an fluctuating trend. Moreover, the profitability position of Ahmad Zaki Resources Berhad has been seen as steadier as compared to its counterpart.

References and bibliography

Ismail, N.A. and King, M., (2014). Factors influencing the alignment of accounting information systems in small and medium sized Malaysian manufacturing firms. *Journal of Information Systems and Small Business*, *1*(1-2), pp.1-20.

Sulaiman, S., Ramli, A. and Mitchell, F., (2016). What factors drive change in management accounting in Malaysian organisations?. *Malaysian Accounting Review*, *7*(1).

Saat, M.M., Porter, S. and Woodbine, G.,(2016). Does religiosity influence ethical sensitivity? An investigation on Malaysian future accountants. *Malaysian Accounting Review*, *8*(2).

Salleh, Z., Stewart, J. and Manson, S., (2016). In The Impact Of Board Composition and Ethnicity On Audit Quality: Evidence From Malaysian Companies. *Malaysian Accounting Review*, *5*(2).

Abdullah, W.Z.W., Ismail, S. and Jamaluddin, N., (2016). The impact of board composition, ownership and CEO duality on audit quality: The Malaysian evidence. *Malaysian Accounting Review*, *7*(2).

Yusoff, H., Yatim, N. and Nasir, N.M., (2016). Analysis on the development of environmental disclosure practices by selected Malaysian companies from 1999 to 2002. *Malaysian Accounting Review*, *4*(1).

Adibah Wan Ismail, W., Anuar Kamarudin, K., van Zijl, T. and Dunstan, K., (2013). Earnings quality and the adoption of IFRS-based accounting standards: Evidence from an emerging market. *Asian Review of Accounting*, *21*(1), pp.53-73.

Sulaiman, M., Majid, N.A. and Ariffin, N.M., (2015). Corporate governance of Islamic financial institutions in Malaysia. *Asian Journal of Business and Accounting*, *8*(1), pp.65-93.

Najeeb, S.F. and Ibrahim, S.H.M., (2014). Professionalizing the role of Shari'ah auditors: How Malaysia can generate economic benefits. *Pacific-Basin Finance Journal*, *28*, pp.91-109.

azrb. (2017). *azrb*. [online] Available at: http://www.azrb.com/annual-report [Accessed 27 Feb. 2017].

Klse.i3investor.com. (2017). *ARK: Annual Report | I3investor*. [online] Available at: https://klse.i3investor.com/servlets/stk/annrep/7007.jsp [Accessed 27 Feb. 2017].