

Financial Performance – Indicators Used In Norwegian Accounting

<u>Profitability Analysis:</u>	Formula	Explanation
Gross Profit	Turnover - Cost of Sales	The turnover equals the annual sales. Cost of sales is defined as (opening stock plus purchases less closing stock).
Gross Profit Margin	$\frac{\text{Gross Profit} * 100}{\text{Turnover}}$	The gross profit margin tells us the profit a business makes on its total sales, i.e. what fraction of each NOK of sales that is left to cover fixed costs and overall profit.
Operating Margin (%)	$\frac{\text{Operating Result} * 100}{\text{Turnover}}$	<i>Operating result</i> (driftsresultat) is a term used to indicate the profit of the operation, i.e. before possible financial income or cost, before tax and before extraordinary income or costs. The common term is <i>EBITDA</i> (<i>Earnings before Interest, Tax, Depreciation and Amortisation</i>). The operating margin shows the profit from operations as a percentage of the turnover.
Return on Total Capital	$\frac{(\text{Operating Result} + \text{Financial Income}) * 100}{\text{Assets (average value)}}$	Shows the return a company has on its total capital, independent of the financial structure. Should at least equal the interest rate on debts.
Return on Equity (Return on Capital Employed - ROCE)	$\frac{\text{Profit Before Extraordinary Costs or Income} * 100}{\text{Equity (average value)}}$	Indicates the profitability in relation to the equity, i.e. the capital invested. Should at least equal the interest rate on bank deposits.
Net Surplus Margin	$\frac{(\text{Operating Result} + \text{Financial Income}) * 100}{\text{Turnover}}$	Indicates the net surplus in relation to total sales, prior to interest on debts.
Asset Turnover Ratio	$\frac{\text{Total Turnover}}{\text{Total Capital (average value)}}$	A measure of how effectively the enterprise uses its total capital and shows how many times the invested capital is "turned over" in a year.
Net Profit Margin	$\frac{(\text{Profit Before Interest and Extraord. Costs}) * 100}{\text{Turnover}}$	Indicates the earnings from each NOK of turnover, i.e. the profitability compared with the total turnover.
<u>Cash Flow Analysis:</u>	Formula	Explanation
Current Ratio (Working Capital Ratio) (Likviditetsgrad 1)	$\frac{\text{Current Assets} + \text{Unused Bank Overdraft}}{\text{Current Liabilities}}$	<i>Unused bank overdraft</i> indicates the difference between the maximum overdraft accepted by the bank and the actual overdraft. The ratio should be greater than 2.
Acid Test Ratio (Likviditetsgrad 2)	$\frac{\text{Current Assets} - \text{Stock} + \text{Unused Bank Overdraft}}{\text{Current Liabilities}}$	<i>Unused bank overdraft</i> indicates the difference between the maximum overdraft accepted by the bank and the actual overdraft. The ratio should be greater than 1.
Working Capital	Current Assets - Current Liabilities	Should preferably be 10 – 15% of the turnover.

<u>Capital Structure Analysis:</u>	Formula	Explanation
Financial Ratio 1	$\frac{\text{Fixed Assets}}{\text{Long Term Liabilities}}$	Indicates to what extent the fixed assets are funded by long term loans. Should be less than 1.
Financial Ratio 2	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Shows to what extent the current liabilities are used to fund the current assets. Should be greater than 2 and definitely not less than 1.
Interest Cover	$\frac{\text{Profit} + \text{Financial Expenses}}{\text{Financial Expenses (e.g. Interest)}}$	Shows the enterprise's profit compared to the interest on loans and thereby expresses the enterprise's vulnerability to new interest bearing obligations. Should exceed 3.
Debt Ratio	$\frac{\text{Debt}}{\text{Equity}}$	Shows to what extent the assets are funded by loans compared to the equity. Should be as low as possible.
Solidity	$\frac{\text{Equity} * 100}{\text{Total Capital}}$	Solidity is a measure of the extent by which the assets are funded by the equity (own capital). Hence, it is a measure of the vulnerability of the creditors' claims. Should preferably be about 30 %.
<u>Other:</u>	Formula	Explanation
Contribution Margin	Turnover - Variable Costs	Indicates the amount available to cover fixed costs and profit.
Contribution Ratio	$\frac{\text{Contribution} * 100}{\text{Annual Sales}}$	Indicates what ration of the turnover that may be used to cover fixed costs and profit.
Debtors' Turnover	$\frac{\text{Average Debtors} * 360}{\text{Credit Sales (including VAT)}}$	Shows the number of days credit given to the enterprise's customers. Should be low.
Creditors' Turnover	$\frac{\text{Average Creditors}}{\text{Credit Purchase of Goods (including VAT)}}$	Shows the number of days credit time from the suppliers (creditors). Should preferably be high.
Stock turnover (Storage Period)	$\frac{\text{Average Stocks} * 360}{\text{Cost of Sales}}$	The number of days goods stay in stock. Should be as low as possible.
Stock Turnover Rate	$\frac{\text{Cost of Sales}}{\text{Stocks}}$	Expresses the turnover of the stock during one year.