Chapter # 6 - Accounting Based Decision Making.

2019 - 08/22

SUMARY

Financial Ratios

Liquidity Ratios

Liquidity Ratios = used to determine the speed at which a company can pay their finantial obligations, the higher the better.

- Current ratio = type of liquidity ratio, most used

$$\boxed{\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current liabilities}}}$$

  - company's ability to pay of current liabilities using its current assets

- Quick Ratio = type of liquidity method, same prorpose as the current, it excludes inventory balances to asses worse case scenario.

$$\boxed{\text{Quick Ratio} = \frac{\text{CurrentAssets - Inventory}}{\text{CurrentLiabilities}}}$$

Profitability Ratios

Profitability Ratios = provides a more accurate ascesment of the net income.

$$\text{ReturnOnAssets} = \frac{\text{NetIncome}}{\text{TotalAssets}}$$

$$\text{ReturnOnEquity} = \frac{\text{NetIncome}}{\text{ShareHoldeirEquty}}$$

- Returne on Assets = profitability in comparison to company's size (in Assets)
- Return on equity = Profitability in comparison to company's equity (in equity), how eficiently is it handling it based on investor's money to profit.

- Gross profit Margin = percentage of sales remaining after covering costs of ~~inventory~~ sold inventory.

$$\boxed{\text{Gross Profit Margin} = \frac{\text{Sales} - \text{Cost Of Goods Sold}}{\text{Sales}}}$$

Used for comparisons between companys to asses whom keeps the inventory costs down, usually done within the same industry.

— Financial Leverage Ratios = to what extend a company has used debt to finance it's operations.

$$\boxed{\text{Debt Ratios} = \frac{\text{Liabilities}}{\text{Assets}}}$$

- Debt-to-equity = shows the debt as opposed to investments from investors.

$$\boxed{\text{Debt Equity Ratio} = \frac{\text{Liabilitys}}{\text{Owners equity}}}$$

— Pros & Cons Of financial Leverage

- it's dangerous to have high leverage
- it's ~~more~~ gives more to be leveraged in the shareholder's equity, but it's risky to run everything on loans

— Asset turnover Ratios = How eficient a company uses it's assets.

- $$\boxed{\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}}$$

- shows how many times a company's inventory is sold and replaced in one period.

- Average Inventory = average inventory part of the equation is calculated:

$$\boxed{\text{Average Inventory} = \frac{\text{Beg. Inventory} + \text{Ending Inventory}}{2}}$$

- Inventory Period : how long inventory is on hand before being sold.

$$\boxed{\text{Inventory Period} = \frac{365}{\text{Inventory Turnover}}}$$

Higher means that inventory is being sold quick so management is doing a good job.

- Receivables Turnover = how quick accounts receivable is being collected.

$$\boxed{\text{Receivables Turnover} = \frac{\text{Credit Sales}}{\text{Average Accounts Receivable}}}$$

- Average collection period = how much time a receivable is outstanding prior to collection.

$$\boxed{\text{Average Collection Period} = \frac{365}{\text{Receivables Turnover}}}$$

Higher is the goal.