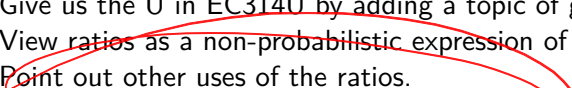


Accounting Ratios

Goals

- ▶ A way of using the definitions you just learned again to make them more solid.
 - ▶ Give us the U in EC314U by adding a topic of general interest.
 - ▶ View ratios as a non-probabilistic expression of risk.
 - ▶ Point out other uses of the ratios.
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The Ratios

<https://prezi.com/gz6nmvsbjrz7/accounting-ratios/>

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Summary of Use

There are multiple uses for each ratio. These are categorized by how we used them in class, not exclusive use.

- ▶ Loan Related

- ▶ Debt Ratio: How likely will a lender be able to recover principal of a loan if borrower stops making payments.
- ▶ TIER: How likely will the borrower make payments on time.
- ▶ Subtleties on which to use when and how to combine depending on if the firm requires few or many assets to produce.

- ▶ Working Capital related

- ▶ Current Ratio: Upper bound on working capital adequacy.
- ▶ Quick Ratio: Lower bound on working capital adequacy.
- ▶ Subtleties on which to use depending on if inventory is firm specific or can be sold for near purchase price.

Summary of Use (Con't)

- ▶ Meeting Increases in Sales
 - ▶ Inventory Turnover: Can you meet a temporary increase in sales?
 - ▶ Asset Turnover: Can you meet a permanent increase in sales?

Warnings/Reminders

Use:

- ▶ Real World use can be different and complex, recall the DuPont example
- ▶ “Good” depends on industry

Typical Exam Questions:

- ▶ A few interpretive questions, “Which firm would you rather lend to”
- ▶ Some require some algebra and require you to remember some accounting definitions and identities.