

# Financial Accounting Ratios

## Profitability Ratios

Ratio	How Calculated	What It Shows
<b>Gross profit margin</b>	Sales - Cost of goods sold / Sales	To indicate the total margin available to cover operating expenses and yield a profit.
<b>Operating profit margin (or return on sales)</b>	Profits before taxes and before interest / Sales	To indicate the firm's profitability from current operations without regard to the interest charges accruing from the capital structure.
<b>Net profit margin (or net return on sales)</b>	Profits after taxes/Sales	Shows after tax profits per dollar of sales. Sub-par profit margins indicate that the firm's sales prices are relatively low or that costs are relatively high, or both.
<b>Return on total assets</b>	Profits after taxes/ Total assets or Profits after taxes + interest/ Total assets	A measure of the return on total investment in the enterprise. It is sometimes desirable to add interest to after-tax profits to form the numerator of the ratio since total assets are financed by creditors as well as by stockholders; hence, it is accurate to measure the productivity of assets by the returns provided to both classes of investors.
<b>Return on stockholder's equity (or return on net worth)</b>	Profits after taxes /Total stockholders' equity	A measure of the rate of return on stockholders' investment in the enterprise.
<b>Return on common equity</b>	Profits after taxes - Preferred stock dividends/ Total stockholders' equity - Par value of preferred stock	A measure of the rate of return on the investment the owners of the common stock have made in the enterprise.
<b>Earnings per share</b>	Profits after taxes - Preferred stock dividends /Number of shares of common stock outstanding	Shows the earnings available to the owners of each share of common stock.

## Liquidity Ratios

<b>Current ratio</b>	Current assets/Current liabilities	Indicates the extent to which the claims of short-term creditors are covered by assets that are expected to be converted into cash in a period roughly corresponding to the maturity of the liabilities.
<b>Quick ratio (or acid-test ratio)</b>	Current assets - Inventory/ Current liabilities	A measure of the firm's ability to pay off short-term obligations without relying on the sale of its inventories.
<b>Inventory to net working capital</b>	Inventory/Current assets - Current liabilities	A measure of the extent to which the firm's working capital is tied up in inventory.

## Leverage Ratios

<b>Debt-to-assets ratio</b>	Total debt/Total assets	Measures the extent to which borrowed funds have been used to finance the firm's operations.
<b>Debt-to-equity ratio</b>	Total debt/Total stockholders' equity	Provides another measure of the funds provided by creditors versus the funds provided by owners.
<b>Long-term debt-to-equity ratio</b>	Long-term debt/Total stockholders' equity	A widely used measure of the balance between debt and equity in the firm's long-term capital structure.
<b>Times-interest-earned (or coverage) ratio</b>	Profits before interest and taxes/ Total interest charges	Measures the extent to which earnings can decline without the firm becoming unable to meet its annual interest costs.
<b>Fixed-charge coverage</b>	Profits before taxes and interest + Lease obligations/ Total interest charges + Lease obligations	A more inclusive indication of the firm's ability to meet all of its fixed-charge obligations.

## Activity Ratios

<b>Inventory turnover</b>	Sales/Inventory of finished goods	When compared to industry averages, it provides an indication of whether a company has excessive or perhaps inadequate finished goods inventory.
<b>Fixed assets turnover</b>	Sales/Fixed assets	A measure of the sales productivity and utilization of plant and equipment.
<b>Total assets turnover</b>	Sales/Total assets	A measure of the utilization of all the firm's assets; a ratio below the industry average indicates the company is not generating a sufficient volume of business, given the size of its asset investment.
<b>Accounts receivable turnover</b>	Annual credit sales/Accounts receivable	A measure of the average length of time it takes the firm to collect the sales made on credit.
<b>Average collection period</b>	Accounts receivable/ Total sales/365 or Accounts receivable/ Average daily sales	Indicates the average length of time the firm must wait after making a sale before it receives payment.

## Other Ratios

<b>Dividend yield on common stock</b>	Annual dividends per share/Current market price per share	A measure of the return to owners received in the form of dividends.
<b>Price-earnings ratio</b>	Current market price per share/ After tax earnings per share	Faster-growing or less-risky firms tend to have higher price-earnings ratios than slower-growing or more-risky firms.
<b>Dividend payout ratio</b>	Annual dividends per share/After tax earnings per share	Indicates the percentage of profits paid out as dividends.
<b>Cash flow per share</b>	After tax profits + Depreciation/ Number of common shares outstanding	A measure of the discretionary funds over and above expenses that are available for use by the firm.