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Financial Ratios

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Financial ratios are categorized into four main areas to identify a business's strengths and weaknesses:

- **Liquidity Ratios**
- **Efficiency Ratios**
- **Solvency Ratios**
- **Profitability Ratios**

Liquidity Ratios

These measure a company's ability to pay its **short-term obligations** as they fall due

- **Current Ratio:** Calculated as ***Current Assets over Current Liabilities***. A ratio of 1 to 1.5 is generally considered satisfactory.
- **Working Capital:** The difference between Current Assets and Current Liabilities (***Current Assets - Current Liabilitie***s).

Efficiency Ratios

These evaluate how effectively a company uses its assets.

- **Receivable Turnover**: Measures how many times a company **collects its average account**s receivable during a period.
- **Average Collection Period**: The average number of days it **takes to collect payments** from customers.
- **Inventory Turnover:** Measures how many times a **company's inventory is sold and replaced** over a period.
- **Average Sales Period:** The average time it takes to **convert inventory into sales.**

Solvency Ratios

Debt-to-Equity Ratio: Measures the proportion of **total liabilities to total equity**, indicating the company's financial leverage and ability to meet long-term obligations.

Profitability Ratios

Gross Profit Ratio and Net Profit Ratio: Used to evaluate the company’s ability to **generate earnings** relative to its sales or costs.

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Thank You