Module 2

The Language and Tools of Financial Analysis

Liquidity Measures (Staying ahead of the curve?)

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Could you pay me now please…

The corporate landscape is littered with liquidity victims, firms that were unable to meet recurring financial obligations.

Accounting liquidity therefore measures short term solvency, as captured by:

Net working capital = current assets – current liabilities

Liquidity ratios

Three ratios capture different levels of liquidity

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Quick Ratio} = \frac{\text{Cash and "near cash"}}{\text{Current Liabilities}}$$

$$\text{Cash Ratio} = \frac{\text{Cash}}{\text{Current Liabilities}}$$

Where "near cash" includes short-term investments and accounts receivable.

Comparison

	KELLOGG'S		KRAFT	
	2014	*2013*	*2014*	*2013*
Current Ratio	0.77	0.85	1.00	1.44
Quick Ratio	0.47	0.53	0.55	0.86
Cash Ratio	0.10	0.07	0.27	0.49

Critical liquidity?

While these numbers look problematic, keep in mind that they only consider the firm's current assets.

Our firm(s) are likely able to generate significant cash quickly from ongoing operations – and therefore be highly liquid.

A mosaic

So there you have it, the financial analyst's toolkit:

- financial statements
- financial ratios
- management discussion and commentary
- earnings announcements
- competitors, industry and macro information

Source list

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