



Accounting Ratios

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Why Ratios Are Important

Profitability Ratios

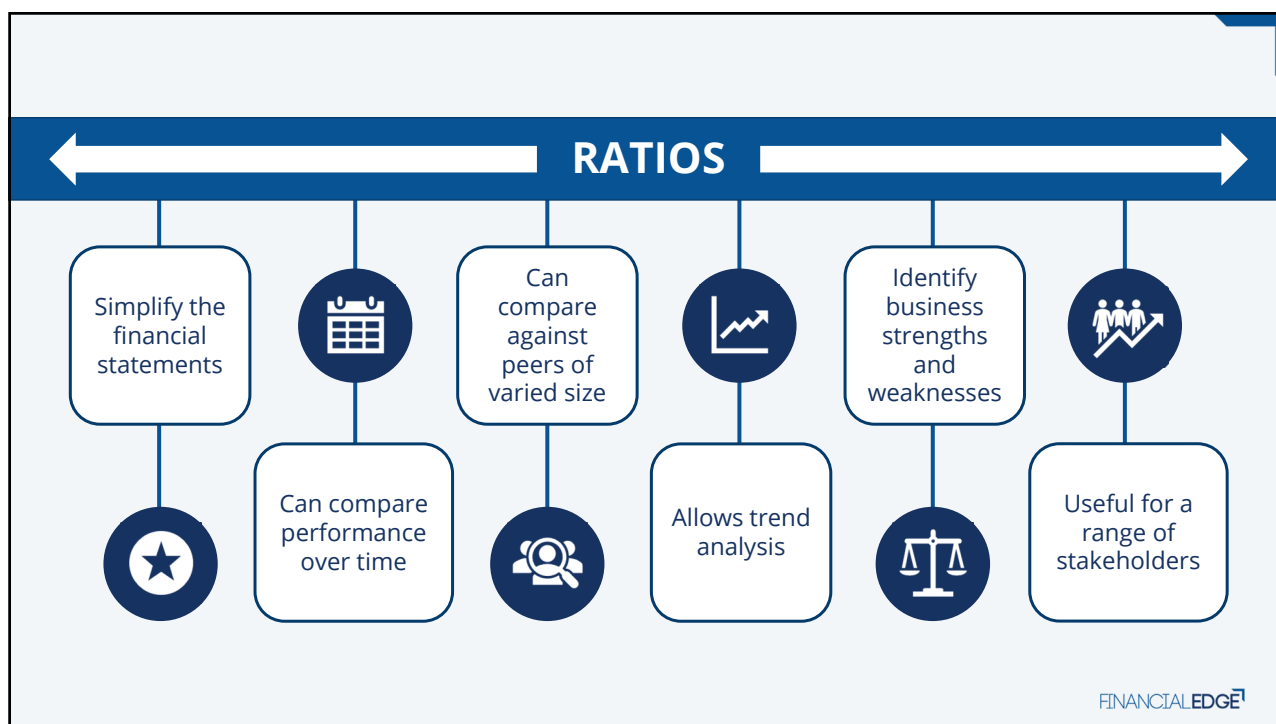
Leverage Ratios

Liquidity Ratios

Asset Ratios

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Why Ratios Are Important

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Profitability Ratios

MARGINS

A measure of profits as a percentage of sales

Profitability shows how well companies can turn their sales into profits

EBIT Margin



EBIT
Sales

EBITDA Margin



EBITDA
Sales

Net Margin



Net income
Sales

EARNING PER SHARE



WHAT IS IT?

How much profit a company makes for each share of its stock.

$$\text{Basic EPS} = \frac{\text{Net income}}{\text{Number of basic shares}}$$

HOW IS IT CALCULATED?

$$\text{Diluted EPS} = \frac{\text{Net income}}{\text{Number of diluted shares}}$$

Return Ratios

RETURN ON EQUITY (ROE)



WHAT IS IT?

The ability of a firm to generate profits from its shareholders investments.

HOW IS IT CALCULATED?

$$\text{Return on equity} = \frac{\text{Net income}}{\text{Shareholders equity}}$$

WHY IS IT IMPORTANT



Measure of profits



Shareholder perspective



Aids comparison

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RETURN ON INVESTED CAPITAL

The ability of a firm is to generate profits from its total invested capital.

Profit from operations **OR**
Return available to financiers

$$\text{ROIC} = \frac{\text{EBIT} \times (1 - \text{Tax Rate})}{\text{Invested Capital}}$$

Used to buy
operating assets

From
financiers



INCOME STATEMENT	
Sales	X
Cost of goods sold (COGS)	(X)
Gross profit	X
Selling, general and admin (SG&A)	(X)
Operating profit / EBIT	X
Interest / finance expense	(X)
Profit before tax	X
Tax expense	(X)
Net income	X

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DIVIDEND PAYOUT RATIO



WHAT IS IT?

The percentage of net income paid out to investors

HOW IS IT CALCULATED?

$$\text{Dividend payout ratio} = \frac{\text{Dividends paid}}{\text{Net income}}$$

WHY IS IT IMPORTANT



Ability to return cash to shareholders



Amount not paid out is retained



Early stage firms retain more cash than mature firms

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Leverage Ratios

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METRIC	FORMULA	MEANING
Net debt	Debt less cash	A company's true indebtedness
Debt to EBITDA ratio	Debt / EBITDA Or Net debt / EBITDA	Tests the ability to repay debt
Debt to equity ratio	Debt / Equity Or Debt / (Debt + Equity)	Measure of non-equity finance to equity finance
Interest coverage ratio	EBITDA / Interest expense	Tests the ability to repay interest


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Liquidity Ratios

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Operating Working Capital (OWC)

Cash tied up in operations



$$\begin{aligned} \text{Operating working capital (OWC)} \\ = \\ \text{Operating current assets (OpCA)} \\ \text{less} \\ \text{Operating current liabilities (OpCL)} \end{aligned}$$

OPERATING BS ITEMS

OWC measures **funds needed to maintain operations.**

Includes **accounts receivable, inventory,** less **accounts payable** etc.

FINANCING BS ITEMS are not included in OWC



METRIC	FORMULA	MEANING
Operating working capital (OWC) to sales	$\text{OWC} / \text{Sales}$	The ratio of short-term assets required to operate a business, compared to sales
Current ratio	$\text{Current Assets} / \text{Current Liabilities}$	Tests the ability to pay short-term obligations
Cash ratio	$\text{Cash} / \text{Current Liabilities}$	Tests the ability to repay short term obligations using just cash (excludes inventory and other illiquid assets)

Other Ratios

Working Capital Days

$$\text{Receivables Days} = \frac{\text{ENDING RECEIVABLES}}{\text{SALES}} \times \text{NUMBER OF DAYS OF SALES}$$

$$\text{Inventory Days} = \frac{\text{ENDING INVENTORY}}{\text{COST OF GOODS SOLD}} \times \text{NUMBER OF DAYS OF COGS}$$

$$\text{Payable Days} = \frac{\text{ENDING PAYABLES}}{\text{COST OF GOODS SOLD}} \times \text{NUMBER OF DAYS OF COGS}$$

