# Interpreting Financial Ratios for any company

**1. Current Ratio**

**Formula**:

Current Ratio=Current AssetsCurrent Liabilities\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}Current Ratio=Current LiabilitiesCurrent Assets​

**Interpretation**:  
Measures a company's ability to cover its short-term liabilities with short-term assets.

* **Good Range**: 1.5 to 2.5  
  A value > 1 means the company has enough short-term assets to pay its short-term debts.
* **Bad Range**: < 1 (may indicate liquidity issues); > 3 (may indicate inefficient use of assets).

**2. Quick Ratio**

**Formula**:

Quick Ratio=Current Assets−InventoryCurrent Liabilities\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}Quick Ratio=Current LiabilitiesCurrent Assets−Inventory​

**Interpretation**:  
A stricter measure of liquidity than the current ratio; excludes inventory, which may be harder to liquidate.

* **Good Range**: 1 to 2  
  Indicates strong short-term liquidity without relying on inventory.
* **Bad Range**: < 1 (struggles to meet short-term obligations).

**3. Net Profit Margin**

**Formula**:

Net Profit Margin=Net IncomeRevenue×100\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenue}} \times 100Net Profit Margin=RevenueNet Income​×100

**Interpretation**:  
Shows how much profit a company makes for every dollar of revenue.

* **Good Range**: 10% to 20% or higher (varies by industry; tech companies often have higher margins).  
  High margins indicate strong pricing power and cost control.
* **Bad Range**: < 5% (may indicate poor profitability).

**4. Operating Margin**

**Formula**:

Operating Margin=Operating IncomeRevenue×100\text{Operating Margin} = \frac{\text{Operating Income}}{\text{Revenue}} \times 100Operating Margin=RevenueOperating Income​×100

**Interpretation**:  
Indicates how efficiently a company manages its operations to generate profit.

* **Good Range**: 10% to 20% or higher.  
  Higher margins indicate efficient operations and cost management.
* **Bad Range**: < 5% (struggles with operational efficiency).

**5. Return on Assets (ROA)**

**Formula**:

ROA=Net IncomeTotal Assets×100\text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}} \times 100ROA=Total AssetsNet Income​×100

**Interpretation**:  
Measures how efficiently a company uses its assets to generate profit.

* **Good Range**: 5% to 20% (higher is better).  
  Higher values indicate effective use of assets.
* **Bad Range**: < 2% (poor asset utilization).

**6. Return on Equity (ROE)**

**Formula**:

ROE=Net IncomeShareholder’s Equity×100\text{ROE} = \frac{\text{Net Income}}{\text{Shareholder's Equity}} \times 100ROE=Shareholder’s EquityNet Income​×100

**Interpretation**:  
Shows how effectively the company generates returns for its shareholders.

* **Good Range**: 10% to 30%.  
  Higher ROE indicates good profitability relative to equity.
* **Bad Range**: < 5% (poor returns for investors).

**7. Debt-to-Equity Ratio**

**Formula**:

Debt-to-Equity=Total DebtShareholder’s Equity\text{Debt-to-Equity} = \frac{\text{Total Debt}}{\text{Shareholder's Equity}}Debt-to-Equity=Shareholder’s EquityTotal Debt​

**Interpretation**:  
Shows the proportion of debt used to finance the company's assets relative to equity.

* **Good Range**: 0.5 to 1.5.  
  Indicates a balanced use of debt and equity.
* **Bad Range**: > 2 (may indicate over-leverage).

**8. Asset Turnover Ratio**

**Formula**:

Asset Turnover=RevenueTotal Assets\text{Asset Turnover} = \frac{\text{Revenue}}{\text{Total Assets}}Asset Turnover=Total AssetsRevenue​

**Interpretation**:  
Indicates how efficiently a company uses its assets to generate revenue.

* **Good Range**: 0.5 to 2.  
  Higher values suggest efficient use of assets.
* **Bad Range**: < 0.5 (inefficient asset utilization).

**9. Inventory Turnover Ratio**

**Formula**:

Inventory Turnover=Cost of Goods SoldAverage Inventory\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}Inventory Turnover=Average InventoryCost of Goods Sold​

**Interpretation**:  
Measures how quickly inventory is sold and replaced over a period.

* **Good Range**: 5 to 10 (varies by industry; retail companies tend to have higher values).  
  Higher values indicate efficient inventory management.
* **Bad Range**: < 3 (slow-moving inventory).

**10. Interest Coverage Ratio**

**Formula**:

Interest Coverage=EBITInterest Expense\text{Interest Coverage} = \frac{\text{EBIT}}{\text{Interest Expense}}Interest Coverage=Interest ExpenseEBIT​

**Interpretation**:  
Indicates a company's ability to pay interest on its debt.

* **Good Range**: > 5 (strong ability to meet interest obligations).
* **Bad Range**: < 2 (may indicate risk of default).

**11. Price-to-Earnings Ratio (P/E)**

**Formula**:

P/E=Price per ShareEarnings per Share (EPS)\text{P/E} = \frac{\text{Price per Share}}{\text{Earnings per Share (EPS)}}P/E=Earnings per Share (EPS)Price per Share​

**Interpretation**:  
Shows how much investors are willing to pay for each dollar of earnings.

* **Good Range**: 10 to 25 (varies by industry).  
  Lower P/E indicates better value, higher P/E suggests growth potential.
* **Bad Range**: > 30 (overvalued), < 5 (possible risk).

**12. Price-to-Sales Ratio (P/S)**

**Formula**:

P/S=Market CapitalizationRevenue\text{P/S} = \frac{\text{Market Capitalization}}{\text{Revenue}}P/S=RevenueMarket Capitalization​

**Interpretation**:  
Shows how much investors are willing to pay per dollar of revenue.

* **Good Range**: 1 to 3.  
  Lower values suggest undervaluation.
* **Bad Range**: > 5 (overvalued).

**13. Price-to-Book Ratio (P/B)**

**Formula**:

P/B=Market CapitalizationBook Value of Equity\text{P/B} = \frac{\text{Market Capitalization}}{\text{Book Value of Equity}}P/B=Book Value of EquityMarket Capitalization​

**Interpretation**:  
Indicates whether a company is over- or undervalued compared to its net assets.

* **Good Range**: 1 to 3.  
  Lower values suggest undervaluation.
* **Bad Range**: > 5 (overvalued).

**Summary Table of Good and Bad Ranges**

|  |  |  |
| --- | --- | --- |
| Ratio | Good Range | Bad Range |
| Current Ratio | 1.5 to 2.5 | < 1 or > 3 |
| Quick Ratio | 1 to 2 | < 1 |
| Net Profit Margin | 10% to 20%+ | < 5% |
| Operating Margin | 10% to 20%+ | < 5% |
| Return on Assets (ROA) | 5% to 20% | < 2% |
| Return on Equity (ROE) | 10% to 30% | < 5% |
| Debt-to-Equity Ratio | 0.5 to 1.5 | > 2 |
| Asset Turnover Ratio | 0.5 to 2 | < 0.5 |
| Inventory Turnover Ratio | 5 to 10 | < 3 |
| Interest Coverage Ratio | > 5 | < 2 |
| Price-to-Earnings Ratio | 10 to 25 | > 30 or < 5 |
| Price-to-Sales Ratio | 1 to 3 | > 5 |
| Price-to-Book Ratio | 1 to 3 | > 5 |

**Conclusion**

These ranges are general guidelines and can vary by industry. Comparing a company’s ratios to its peers and historical values is essential for meaningful analysis. Let me know if you'd like to dive deeper into any specific ratio or adjust the ranges for a particular sector!