Types of Ratio Analysis and their Role in Valuation

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- Ratio Analysis is a technique for evaluating a company performance by analysing its financial statements over a period of time
- This enables the performance of the company to be evaluated over time and compared to its peers
- It also provides us with some tools for use in valuation

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- There are five types of Ratio Analyses
    - Profitability Ratios
    - Solvency Ratios
    - Liquidity Ratios
    - Turnover Ratios
    - Earnings Ratios

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- Many of these ratios are measures of performance not of valuation
- Ratio Analysis in this respect is a separate discipline to Valuation
- We can adapt the Ratio approach for use in Valuation

Types of Ratio Analysis and their Role in Valuation

- When we combine financial information with price data we are able to create ratios which we can then apply to target companies to "value" them on a comparative basis
- We can also use these ratios to evaluate compatibility of peer group companies with a target company

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- Earnings Ratios can be used to generate comparative values
  - Earnings Per Share
  - Price Earnings Ratio
  - PEG - Price Earnings to Growth

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- We can generate valuation ratios by comparing Income Statement data to Market Capitalisation (Equity) or Enterprise Values

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- EV/Sales
- EV/EBITDA
- EV/EBIT
- EV/PAT or Net Income

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- Balance Sheet data can be used as well
  - EV/Capital Employed
  - Price to Book Ratio

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- The Cash Flow Statement enables us to create valuation ratios too
  - EV/FCF
  - Price/Cash Flow

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