Financial Ratios
E book

CFI EDUCATION

MARGIN RATIOS

Gross Profit Margin = Gross Profit / Revenue

EBITDA Margin = EBITDA / Revenue

Operating Profit (EBIT) Margin = EBIT / Revenue

Net Profit Margin = Net Income / Revenue

PROFITABILITY RATIOS

Return on Equity (RoE) = Net Income / Avg Equity

Return on Assets (RoA) = Net Income / Avg Assets

Return on Capital Employed (RoCE) = EBIT / (Avg Total Assets - Avg Current Liabilities)

LIQUIDITY RATIOS

Current Ratio

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Current Ratio = Current Assets / Current Liabilities

Ratio of current assets and current liabilities. It measures the liquidity position of a firm.

Ideal ratio is 2:1 or more. A low CR, say 0.5:1, means company has Rs.50 for every Rs.100 of debt and can't cover its short-term debts.

Quick Ratio

Quick Ratio = Quick Assets / Current Liabilities

also known as Acid Test Ratio

Quick Ratio = (Current Assets - Inventories) / Current Liabilities

A measure of short-term solvency of a firm

Reliable because assets forming part of quick assets are easily convertible into cash in short notice. Quick ratio of 1.5:1 represents satisfactory financial situation.

Cash Ratio

Cash Ratio = (Cash + Marketable securities) / Current Liabilities

Measures a firm's ability to pay off its short-term liabilities with cash and cash equiva¬lents.

LEVERAGE RATIOS

Debt Ratio

Debt Ratio = Total Debt / Total Assets

It measures the relative amount of company's assets that are financed by Debt

High Debt Ratio = Higher financial risk

Debt Equity Ratio

D/E Ratio = Total Debt / Total Common Equity

Ratio of firm's total liabilities to Equity Capital

High D/E Ratio indicates higher risk to the shareholders

Debt EBITDA Ratio

Debt EBITDA = Debt / EBITDA

where:

Debt = Long-term and short-term debt obligations

EBITDA = Earnings before interest, taxes, depreciation, and amortization

Lenders, valuation experts, and investors all use the debt/EBITDA ratio to assess a company's financial strength.

Banks and debt capital providers use this ratio to see how much debt they can issue (usually upto 4x).

COVERAGE RATIO

Interest Coverage Ratio

ICR = Operating Income / Interest Expenses

IT shows how easily a firm can pay its interest expenses.

Debt Service Coverage Ratio

DSCR = Operating Income / Total Debt Service

It reveals how easily a firm can pay its debt obligations.

Leverage Ratios or Debt Management Ratios indicate the extent to which debt financing is used by a firm. These ratios measure long-term solvency of a firm.

TURNOVER RATIOS

Receivables Turnover Ratio

RTOR = Annual Sales / Accounts Receivables

Days Sales Outstanding

DSO = (Receivables x No. of days) / Total Sales

It is used to evaluate a firm's ability to collect its sales in timely manner

It is a measure of quality of debtors as It shows the average length of time that a firm takes to realize in cash after sales has been made

Inventory Turnover Ratio

ITR = Cost of Goods Sold / Avg Inventory

Days of inventory on hand

DIH = 365 / Inventory turnover

It is used to evaluate how long the firm takes to sell the inventory on average. Or how many days of inventory the company keep with itself.

Payable turnover Ratio

PTR = COGS / Avg. Account Payables

Days payable outstanding

DPO = 365 / Payable turnover
The days payable outstanding (DPO) calculation determines the typical time a business requires to settle its suppliers' payables.

Cash Conversion Cycle = DSO + DIH -DPO

MARKET VALUES RATIOS

Price Earnings Ratio

PE Ratio = Market Price (per Share) / Earnings (per Share)

Ratio of company's stock price to the earnings per share can only be calculated for listed companies. Higher PE ratio = higher growth rate of the firm

Price to Book Value Ratio

PB Ratio = Price / Book Value (per Share)

Comparison of market value with book value of a firm

IF MTBR<1, undervaluation; IF MTBR > 1, over valuation.

Dividends Per Share

DPS = Total Dividends / No. of Shares

Total dividends shared per unit share.

Higher DPS = much profitable for shareholders

Dividends Pay-out Ratio

Pay-out Ratio = Dividends (per Share) / Earnings (per Share)

The amount of dividend that a company gives out to its shareholders out to its current earnings.

Dividend Yield Ratio

DYR = Dividend (per Share) / Share Price

It measures the amount of dividends attributed to shareholders relative to the market value per share

Market Values Ratios represent the ratios that relate the firm's stock price to its earnings and Stock Value per Share