

# FINANCIAL RATIOS

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- Performance
- Activity
- Short-Term Liquidity
- Long-Term Solvency

# PERFORMANCE

## PROFITABILITY BASED

- Profit Margin

- Profit Margin = 
$$\frac{\text{Net Income}}{\text{Sales}}$$

- Earnings per Share (EPS)

- Earnings per Share = 
$$\frac{\text{Net Income}}{\text{Shares Outstanding}}$$

# MARKET BASED

- Price-to-Earnings (PE)

- Price-to-Earnings = 
$$\frac{\text{Share Price}}{\text{Earnings per Share}}$$

- Market-to-Book (MB)

- Market to Book Ratio = 
$$\frac{\text{Share Price}}{\text{Book Value per Share}}$$

# ACTIVITY

- Involve turnover
  - Efficiency

- $$\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Inventory}}$$

- Too much inventory is not efficient

# SHORT TERM LIQUIDITY

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

- Quick Ratio removes inventory:

$$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$$

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

# LONG-TERM SOLVENCY

- Debt to Equity Ratio =  $\frac{\text{Total Debt}}{\text{Total Equity}}$



- Cash Coverage Ratio =  $\frac{\text{EBIT} + \text{Depreciation}}{\text{Interest Expense}}$
- Remember:  $\text{OCF} = \text{EBIT} + \text{Depreciation} - \text{Taxes}$

# SUMMARY

- Performance  
    Profitability and Market
- Activity
- Short-Term Liquidity  
    Day-to-day cash availability
- Long-Term Solvency