FINANCIAL RATIO

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FINANCIAL RATIO

 A financial ratio (or accounting ratio) is a relative magnitude of two selected numerical values taken from an enterprise's financial statement.

SOURCES OF DATA FOR FINANCIAL RATIOS

- Balance Sheet
- Income Statement
- Statement of Cash Flow
- Statement of Retained Earnings

PURPOSE AND TYPES OF RATIOS

- Liquidity ratios
- Asset turnover ratios
- Financial leverage ratios
- Profitability ratios
- Dividend policy ratios

PURPOSE AND TYPES OF RATIOS

Financial ratios allow for comparisons

- between companies
- between industries
- between different time periods for one company
- between a single company and its industry average

LIQUIDITY RATIOS

Provides information about a firm's ability to meet its short-term financial obligations.

CURRENT RATIO = Current Assets Current Liabilities

Current Assets - Inventory

QUICK RATIO =

Current Liabilities

Cash + Marketable Securities

CASH RATIO =

Current Liabilities

ASSET TURNOVER RATIO

Indicates of how efficiently the firm utilizes its asset.

	Annual Credit Sales	
RECEIVABLE TURNOVER =	Accounts Receivable	

	Accounts Receivable
AVERAGE COLLECTION PERIOD=	Annual Credit Sales / 365

	365	
AVERAGE COLLECTION PERIOD=	Receivable Turnover	

ASSET TURNOVER RATIO

INVENTORY TURNOVER =

Cost of Goods Sold

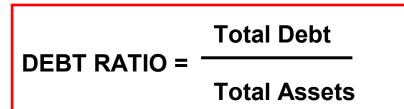
Average Inventory

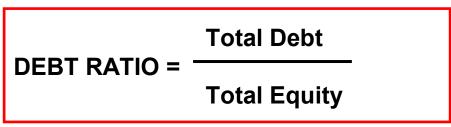
INVENTORY PERIOD =	Average Inventory
	Annual Cost of Goods Sold / 365

	365
INVENTORY PERIOD = -	Inventory Turnover

FINANCIAL LEVERAGE RATIOS

Provide an indication of the long-term solvency of the firm.







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PROFITABILITY RATIO

Offer several different measures of the success of the firm at generating profits.

Gross Profit Margin is a measure of the gross profit earned on sales.

	Sales – Cost of Goods Sold
GROSS PROFIT MARGIN =	Sales

PROFITABILITY RATIO

Return on Assets is a measure of how effectively the firm's assets are being used to generate profits.

RETURN ON ASSETS =	Net Income
	Total Assets

PROFITABILITY RATIO

Return on Equity is the bottom line in measure for the shareholder profits earned for each dollar invested in the firm's stock.

	stock.	Net Income
RETURN ON EQUITY=	Shareholder Equity	

DIVIDEND POLICY RATIO

Provide insight into the dividend policy of the firm and the prospects for future growth.

	Dividends Per Share
DIVIDEND YIELD =	Share Price

PAYOUT RATIO =	Dividends Per Share
	Earnings Per Share

USE AND LIMITATIONS OF FINANCIAL RATIO

- 1. A reference point is needed
- 2. Most ratios by themselves are not highly meaningful
- 3. Year-end values may not be representative
- 4. Ratios are subjects to the limitations of accounting methods

CAPITAL BUDGETING RATIO

- Net present value
- Profitability index
- Internal rate of return
- Modified internal rate of return
- Equivalent annuity