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

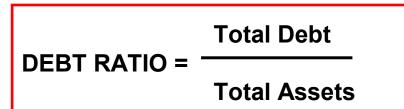
Average Inventory

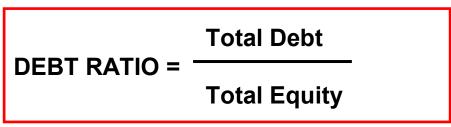
| INVENTORY PERIOD = | Average Inventory |
|--------------------|---------------------------------|
| | Annual Cost of Goods Sold / 365 |

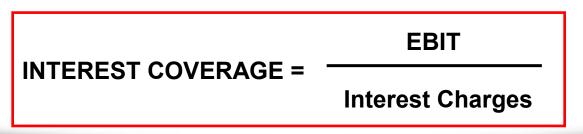
| | 365 |
|----------------------|--------------------|
| INVENTORY PERIOD = - | Inventory Turnover |

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