Financial Ratios

Formula, Example, Explanation

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Liquidity Ratios

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Liquidity Ratios

1.Current Ratio:

- Formula: Current Assets / Current Liabilities
- Example: Current assets of $200,000 and current liabilities of $100,000 result in a current ratio of 2:1.
- Explanation: Indicates a company's ability to cover short-term obligations. A ratio above 1 suggests good liquidity.

2. Quick Ratio (Acid-Test Ratio):

- Formula: (Current Assets - Inventory) / Current Liabilities
- Example: Quick assets of $150,000 and current liabilities of $75,000 result in a quick ratio of 2:1.
- Explanation: Similar to the current ratio but excludes inventory, providing a more conservative measure of liquidity.

3. Cash Ratio:

- Formula: Cash and Cash Equivalents / Current Liabilities
- Example: $50,000 in cash and $25,000 in current liabilities result in a cash ratio of 2:1.
- Explanation: Focuses solely on the most liquid assets, providing a stringent measure of short-term liquidity.

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Profitability Ratios

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Profitability Ratios

4. Net Profit Margin:

- Formula: Net Profit / Revenue
- Example: Net profit of $50,000 and revenue of $500,000 result in a net profit margin of 10%.
- Explanation: Measures the percentage of profit relative to revenue. Higher margins indicate better profitability.

5. Return on Assets (ROA):

- Formula: Net Income / Average Total Assets
- Example: Net income of $80,000 and average total assets of $400,000 result in an ROA of 20%.
- Explanation: Assesses how efficiently a company utilizes its assets to generate profit.

6. Return on Equity (ROE):

- Formula: Net Income / Average Shareholders' Equity
- Example: Net income of $60,000 and average equity of $300,000 result in an ROE of 20%.
- Explanation: Evaluates the returns generated for shareholders' equity. A higher ROE is typically favorable.

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Solvency Ratios

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Solvency Ratios

7. Debt to Equity Ratio:

- Formula: Total Debt / Shareholders' Equity
- Example: Total debt of $200,000 and equity of $300,000 result in a debt to equity ratio of 0.67.
- Explanation: Measures the proportion of debt relative to equity. Lower ratios indicate lower financial risk.

8. Interest Coverage Ratio:

- Formula: Earnings Before Interest and Taxes (EBIT) / Interest Expense
- Example: EBIT of $120,000 and interest expense of $20,000 result in an interest coverage ratio of 6.
- Explanation: Assesses a company's ability to cover interest payments with its earnings.

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Efficiency Ratios

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Efficiency Ratios

9. Inventory Turnover:

- Formula: Cost of Goods Sold / Average Inventory
- Example: COGS of $200,000 and average inventory of $40,000 result in an inventory turnover of 5.
- Explanation: Indicates how quickly a company sells and replaces its inventory.

10. Receivables Turnover:

- Formula: Revenue / Average Accounts Receivable
- Example: Revenue of $600,000 and average accounts receivable of $80,000 result in a receivables turnover of 7.5.
- Explanation: Measures how efficiently a company collects cash from its customers.

11. Asset Turnover:

- Formula: Revenue / Average Total Assets
- Example: Revenue of $1,000,000 and average total assets of $500,000 result in an asset turnover of 2.
- Explanation: Assesses how efficiently a company uses its assets to generate revenue.

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Valuation Ratios

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Valuation Ratios

12. Price-to-Earnings (P/E) Ratio:

- Formula: Market Price per Share / Earnings per Share (EPS)
- Example: If the market price is $40 and EPS is $5, the P/E ratio is 8.
- Explanation: Compares the market price of a share to its earnings. A higher P/E may indicate expectations for future growth.

13. Price-to-Book (P/B) Ratio:

- Formula: Market Price per Share / Book Value per Share
- Example: With a market price of $60 and book value of $20, the P/B ratio is 3.
- Explanation: Measures the market's valuation of a company relative to its book value. A ratio above 1 can suggest overvaluation.

14. Dividend Yield:

- Formula: Dividends per Share / Market Price per Share
- Example: If dividends are $2 per share and the market price is $50, the yield is 4%.
- Explanation: Represents the annual dividend income relative to the market price of a share.

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Return Ratios

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Return Ratios

15. Return on Capital Employed (ROCE):

- Formula: Earnings Before Interest and Taxes (EBIT) / Capital Employed
- Example: If EBIT is $100,000 and capital employed is $500,000, ROCE is 20%.
- Explanation: Evaluates the efficiency of capital utilization in generating returns.

16. Earnings Growth Rate:

- Formula: (Current Year EPS - Last Year EPS) / Last Year EPS
- Example: If last year's EPS was $4 and this year's is $5, the growth rate is 25%.
- Explanation: Indicates the percentage change in earnings from one period to another.

17. Sales Growth Rate:

- Formula: (Current Year Sales - Last Year Sales) / Last Year Sales
- Example: If last year's sales were $800,000 and this year's are $1,000,000, the growth rate is 25%.
- Explanation: Measures the percentage change in sales from one period to another.

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Coverage Ratios

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Coverage Ratios

18. Fixed Charge Coverage Ratio:

- Formula: (EBIT + Lease Payments) / (Interest + Lease Payments)
- Example: With EBIT of $120,000, lease payments of $10,000, interest of $15,000, and lease payments of $10,000, the ratio is 7.
- Explanation: Evaluates a company's ability to cover fixed charges with its earnings.

19. Debt Service Coverage Ratio:

- Formula: Net Operating Income / Debt Service
- Example: With NOI of $150,000 and debt service of $100,000, the ratio is 1.5.
- Explanation: Measures a company's ability to meet its debt obligations.

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Growth Ratios

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Growth Ratios

20. Dividend Growth Rate:

- Formula: (Current Year Dividends - Last Year Dividends) / Last Year Dividends
- Example: If last year's dividends were $1 and this year's are $1.20, the growth rate is 20%.
- Explanation: Indicates the percentage change in dividends from one period to another.

21. Retention Ratio:

- Formula: (Net Income - Dividends) / Net Income
- Example: If net income is $100,000 and dividends are $20,000, the retention ratio is 80%.
- Explanation: Measures the percentage of earnings retained by the company for reinvestment.

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Market Ratios

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Market Ratios

22. Market Capitalization:

- Formula: Number of Shares Outstanding * Market Price per Share
- Example: With 1 million shares and a market price of $50, the market cap is $50 million.
- Explanation: Represents the total market value of a company's outstanding shares.

23. Earnings per Share (EPS):

- Formula: Net Income / Weighted Average Shares Outstanding
- Example: If net income is $200,000 and weighted average shares outstanding are 50,000, EPS is $4.
- Explanation: Represents the earnings attributable to each outstanding share.

24. Dividends per Share:

- Formula: Total Dividends Paid / Number of Shares Outstanding
- Example: If total dividends are $50,000 and shares outstanding are 10,000, dividends per share are $5.
- Explanation: Represents the dividends distributed per outstanding share.

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Payout Ratios

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Payout Ratios

25. Dividend Payout Ratio:

- Formula: Dividends per Share / Earnings per Share
- Example: If dividends per share are $2 and EPS is $4, the payout ratio is 50%.
- Explanation: Measures the percentage of earnings paid out as dividends.

26. Retention Ratio:

- Formula: (Net Income - Dividends) / Net Income
- Example: If net income is $100,000 and dividends are $20,000, the retention ratio is 80%.
- Explanation: Measures the percentage of earnings retained by the company for reinvestment.

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Efficiency and Turnover Ratios

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Efficiency and Turnover Ratios

27. Fixed Asset Turnover Ratio:

- Formula: Revenue / Average Fixed Assets
- Example: If revenue is $1,000,000 and average fixed assets are $200,000, the turnover is 5.
- Explanation: Measures how efficiently fixed assets generate revenue.

28. Working Capital Turnover Ratio:

- Formula: Revenue / Average Working Capital
- Example: If revenue is $800,000 and average working capital is $100,000, the turnover is 8.
- Explanation: Assesses the efficiency of working capital in generating revenue.

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