



Business Ratios

Current Ratio

Measures whether or not the firm has enough resources to pay its debt over the next 12 months – formula:

$$\text{Current Ratio} = \text{Current Assets} \div \text{Current Liabilities}$$

Acceptable ratios are between 1.5 and 2 – below 1 the company may have issues meeting its short term obligations

Quick Ratio

Measures the ability of a company to use its near cash or quick assets to pay off its current liabilities immediately. A company with a quick ratio of less than 1 cannot currently fully pay back its current liabilities.

$$\text{Quick Ratio} = \frac{\text{Cash and Cash Equivalent} + \text{Marketable Securities} + \text{Accounts Receivable}}{\text{Current Liabilities}}$$

Gross Profit Margin

This number is the difference between retail and cost shown as a %.

This number needs to be as high as possible while maintaining a competitive price.

$$\text{Retail} - \text{Cost} \div \text{Retail} = \text{GM\%}$$

Net Profit Margin

Net profit margin is the percentage of revenue left after all expenses have been deducted from sales.

The number should be as high as possible – this report is showing growth in regards to the Net Profit Margin.

$$\text{Net Profit Margin} = \text{Net Profit} \div \text{Revenue}$$



Inventory Days

The inventory days shows the number of days it takes to turn their inventory. The lower the number the better, however there is a happy medium. We don't want the inventory so low that we miss sales.

$$\text{Days Sales of Inventory} = \left(\frac{\text{Inventory}}{\text{Cost of Sales}} \right) \times 365$$

Accounts Receivable Days

This number shows the number of days it takes to collect its accounts receivables. If the industry average terms are net 30 then it takes the industry and additional 8.6 days to collect their receivables. So depending on the terms – the number to watch with is the number over and above your terms. The lower the number the better.

$$\left(\text{Accounts receivable} \div \text{Annual revenue} \right) \times \text{Number of days in the year}$$

Accounts Payable Days

This number measures the number of days that a company takes to pay its suppliers.

$$\frac{\text{Total supplier purchases}}{(\text{Beginning accounts payable} + \text{Ending accounts payable}) \div 2}$$

Interest Coverage Ratio

The interest coverage ratio is a debt ratio and profitability ratio used to determine how easily a company can pay interest on outstanding debt. The interest coverage ratio may be calculated by dividing a company's earnings before interest and taxes (EBIT) during a given period by the amount a company must pay in interest on its debts during the same period.



A high ratio indicates that a company can pay for its interest expense several times over, while a low ratio is a strong indicator that a company may default on its loan payments. Once a company hits 1.5 or below, red flags start to go up.

$$\text{Interest Coverage Ratio} = \frac{\text{EBIT}}{\text{Interest Expense}}$$

Debt to Equity Ratio

This measures the riskiness of a company's financial structure. The ratio reveals the relative proportions of debt and equity financing that a business employs. A low number is a good number.

$$\frac{\text{Long-term debt} + \text{Short-term debt} + \text{Leases}}{\text{Equity}}$$

Debt Service Coverage Ratio

Is the ratio of cash available for debt servicing to interest, principal and lease payments? It's the measurement of an entity's ability to produce enough cash to cover its debt. The higher the ratio the easier it is to obtain the loan.

$$\frac{\text{Net Annual Operating Income}}{\text{Total of Annual Loan Payments}}$$

Return on Equity

The return on equity ratio shows how much profit each dollar of common stockholders' equity generates.

$$\text{Return on Equity} = \text{Net Income} \div \text{Shareholder's Equity}$$



Return on Assets

Shows the percentage of how profitable a company's assets are in generating revenue. ROA's over 5% are generally considered good.

$$ROA = \text{Net Income} \div \text{Average Total Assets}$$

Gross Fixed Asset Turnover

The ratio of sales (on the profit and loss account) to the value of fixed assets (on the balance sheet). It indicates how well the business is using its fixed assets to generate sales.

$$\frac{\text{Net annual sales}}{\text{Gross fixed asset} - \text{Accumulated depreciation}}$$

Profit per Employee

The higher the number the more efficiently the company uses its employees. This number can only be compared to other companies when these companies are similar.

$$\text{Net Revenue} \div \text{number of employees}$$



Cost of Goods Sold (COGS)

The cost of Goods Sold for a manufacturer is the cost of finished goods in its beginning inventory plus the cost of goods manufactured minus the cost of finished goods in ending inventory.

$$\textit{Beginning Inventory} + \textit{Purchases} - \textit{Ending Inventory} = \textit{Cost of Goods Sold}$$

Gross Profit

The difference between revenue and cost. This number shows in a % how much money that is being made on the merchandise.

$$\textit{Net Sales} - \textit{COGS} \div \textit{Net Sales} = \textit{GP}$$

Depreciation

A reduction in the value of an asset with the passage of time, due in particular to wear and tear.

$$\textit{Depreciable Amount} \div \textit{Useful Life}$$

EBIDTA

Earnings before interest, taxes, depreciation and amortization is an indicator of a company's financial performance.

$$\textit{EBITDA} = \textit{Revenue} - \textit{Expenses (excluding tax, interest, depreciation and amortization)}.$$

Net Income

A company's total earnings or profit, the higher the number the better.

$$\textit{Total Revenue} - \textit{COGS} - \textit{Expenses or GP\$} - \textit{Expenses}$$