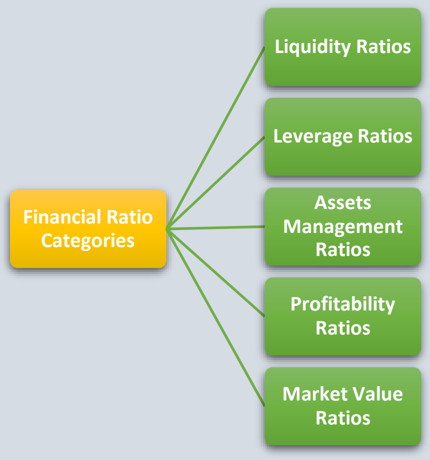
For More Details: https://www.ezilearning.com/most-important-financial-ratios.html

Financial Ratios

The financial ratio refers to the comparison of two accounting figures or data, generally from financial statements i.e., income statements, and balance sheets. The reason behind computing the financial ratio is to compare the strength and weaknesses as well as the financial health and stability of the firms with other competitors or within the organization through one accounting period to another.

Financial Ratio are categorized into 5 different categories. Each of which serves different perspective on company financial health and performance.



1. Liquidity Ratios

This financial ratio deals with the question of how well the firm is able to meet its current obligation.

Types of Liquidity Ratios;

1.1. Current Ratio

The current Ratio measures the firm's ability to pay off its short-term obligation.

Formula to calculate:

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

1.2. Quick-Ratio

It is similar to current ratio but without relying on the sale of inventories.

Formula to Calculate:

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

2. Leverage Ratios

Leverage ratios are intended to address the firm's long-run ability to meet its obligations or, more generally, its financial leverage.

Types of Leverage Ratios

2.1. Debt-Assets Ratio

This ratio measures how the firm is using borrowed funds to finance its assets.

Formula to Calculate;

$$\text{Debt-Assets Ratio} = \frac{\text{Total Debts}}{\text{Total Assets}}$$

2.2. Debt-Equity Ratio

This ratio measures the proportion of assets financed by debt relative to the shareholder's equity.

Formula to calculate;

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

3. Assets Management/Efficiency Ratio

This ratio measure how effectively the firm manages its assets in generative revenue.

Types of Efficiency Ratios

3.1. Inventory Turnover Ratio

This ratio measures the firm's efficiency in managing its inventories.

Formula to calculate;

$$ITOR = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

3.2. Receivable Turnover Ratio

This ratio measures the productivity of investment in receivables and also test the liquidity of receivables of a firm.

Formula to calculate;

$$\text{RTOR} = \frac{\text{Annual Credit Sales}}{\text{Average Account Receivable}}$$

3.3. Fixed Assets Turnover Ratio

This ratio measures how effectively and efficiently the fixed assets of the firms are utilized and generate revenue.

Formula to calculate;

$$\text{RTOR} = \frac{\text{Annual Sales}}{\text{Net Fixed Assets}}$$

3.4. Total Assets Turnover Ratio

This ratio measures how effectively and efficiently the overall assets of the firms are utilized and generate sales revenue.

Formula to calculate;

$$\text{TATOR} = \frac{\text{Sales Revenue}}{\text{Total Assets}}$$

4. Profitability Ratios

The financial ratio which measures the overall operating efficiency of the company

Types of Profitability Ratios

4.1. Gross Margin Ratio

This ratio measures the firm's efficiency in generating gross profit with respect to sales.

Formula to calculate;

$$\text{Gross Margin Ratio} = \frac{\text{Gross Profit}}{\text{Sales}}$$

4.2. Net Profit Margin

The financial ratio measures the firm's efficiency in generating net profit with respect to sales.

Formula to calculate;

$$\text{Net Profit Margin} = \frac{\text{Net Profit after tax}}{\text{Sales}}$$

4.3. Return on Assets Ratio

The financial ratio that measures the overall effectiveness of management in generating profit (net profit) with its available assets.

Formula to calculate;

$$\text{ROA} = \frac{\text{Net Profit after tax}}{\text{Total Assets}}$$

4.4. Return on Equity

The financial ratio that measures the firm ability to utilize the owner's fund in generating the firm's profitability.

Formula to calculate;

$$\text{ROE} = \frac{\text{Net Profit after tax}}{\text{Total Equity}}$$

5. Market Value Ratio

The financial ratio that measures firms' overall performance or value relative to the current market price. This ratio are calculated only to public limited company.

5.1. Price-Earnings Ratio

The financial ratio that indicates the amount that the investors are ready to pay for each rupee of the firm's earnings.

Formula to calculate;

$$\text{Price-Earnings ratio} = \frac{\text{Market Price Per Share}}{\text{Earning Per Share}}$$

5.2. Market-to-Book Value ratio

The financial ratio that measures how much investors are willing to pay for a company's shares relative to its book value.

Formula to calculate;

$$\text{Market-to-Book Value ratio} = \frac{\text{Market Price Per Share}}{\text{Book Value Per Share}}$$