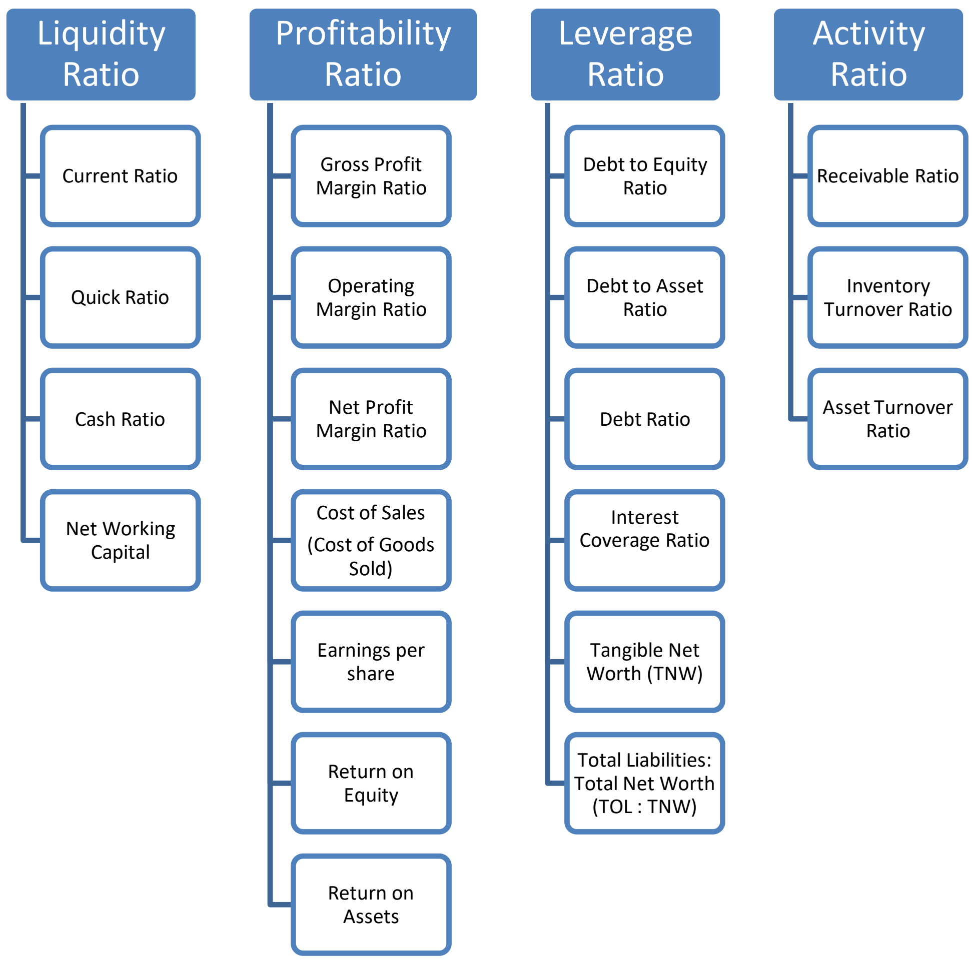
ACCOUNTING RATIOS

Accounting Ratio is the comparison of two or more financial data which are used for analyzing the financial statements of companies. It is an effective tool used by the shareholders, creditors and all kinds of stakeholders to understand the profitability, strength and financial status of companies.

This is also widely known as Financial Ratios based on which business performance can be monitored and important business decisions are made.

Accounting Ratios (Financial Ratios)



	Particulars	Formulae	Description
A.	**Liquidity Ratio**		- Liquidity ratio helps in measuring the cash sufficiency of an enterprise to pay off its short-term liabilities. - A High liquidity ratio ensures the company is in a good position to pay its creditors. - The liquid ratio of 2 or more is considered acceptable.
1.	Current Ratio (CR) Or Working Capital Ratio.	$= \frac{\text{Current Assets}}{\text{Current Liabilities}}$	- This is a liquidity ratio that measures a company's ability to pay short-term obligations or those due within one year. - A current ratio that is in line with the industry average or slightly higher is generally considered acceptable. - A current ratio that is lower than the industry average may indicate a higher risk of distress or default. Similarly, if a company has a very high current ratio compared to their peer group, it indicates that management may not be using their assets efficiently.
2.	Quick Ratio (QR) Or Acid Test Ratio	$= \frac{\text{[Current Assets (–) Inventory (-) Prepaid Expenses]}}{\text{Current Liabilities}}$	- It indicates the company's ability to instantly use its near-cash assets (assets that can be converted quickly to cash) to pay down its current liabilities. - The quick ratio is considered a more conservative measure than the current ratio, which includes all current assets as coverage for current liabilities - The higher the ratio result, the better a company's liquidity and financial health; the lower the ratio, the more likely the company will struggle with paying debts.
3.	Cash Ratio	$= \frac{\text{[Cash + Marketable Securities]}}{\text{Current Liabilities}}$	- This ratio considers only those current assets which are immediately available to the company to pay its debts. - Business is considered as financially sound if it has a cash ratio of 1 or more.
4.	Net Working Capital (NWC)	= Current Assets (–) Current Liabilities	- It gives an idea of a business's liquidity and whether the company has enough money to cover its short-term obligations. - If the net working capital figure is zero or greater, the business is able to cover its current obligations.

B.	**Profitability Ratio**		- Profitability ratio is generally used to determine how well the business is generating profits from its operations.
1.	Gross Profit Margin	$= \dfrac{[\text{Revenue } (-) \text{ Cost of Sales}]}{\text{Revenue}}$ $= \dfrac{\text{Gross Profit}}{\text{Revenue}}$	- It is a metric analysts use to assess a company's financial health by calculating the amount of money left over from product sales after subtracting the cost of goods sold (COGS).
2.	Operating Margin	$= \dfrac{\text{Gross profit } (-) \text{ Operating expenses}}{\text{Revenue}}$	- Unlike Gross profit ratio, this includes more expenses and hence it is used to ascertain company's profitability more efficiently. - From the gross profits, operating expenses such as selling and distribution cost, administration cost etc. are deducted to arrive at operating margin
3.	Net Profit Margin	$= \dfrac{\text{Net Profit}}{\text{Revenue}}$	- It is the amount of profit made after deducting selling, general, and administrative costs, from gross profit. This illustrates how much of revenue collected by a company translates into profit.
4.	Cost of Sales Or Cost of Goods Sold	= Beginning Inventory + Purchases (–) Ending Inventory	- It is the accumulated total of all costs used to create a product or service, which has been sold. - The cost of sales is a key part of the performance metrics of a company, since it measures the ability of an entity to design, source, and manufacture goods at a reasonable cost - It does not include any general and administrative expenses. It also does not include any costs of the sales and marketing department.
5.	Earnings Per Share (EPS)	$= \dfrac{\text{Net Income (-) Preferred Dividend}}{\text{Weighted Average outstanding Shares}}$	- EPS is more important to shareholders since it helps in determining the return on investment. - Generally weighted average Outstanding shares are used since outstanding shares can change over time - Higher the EPS, higher is the stock price of the company. - Sometime Diluted EPS are used which includes options, convertible securities and warrants outstanding which affects outstanding shares.

6.	Return on Equity (ROE)	$= \frac{\text{Net Profit}}{\text{(Opening Equity + Closing Equity)/2}}$	- This is a measure of financial performance calculated by dividing net income by shareholders' equity. - It is considered a measure of the profitability of a corporation in relation to stockholders' equity.
7.	Return on Assets (ROA)	$= \frac{\text{Net Profit}}{\text{(Opening Total Assets + Closing Total Assets)/2}}$	- This is an indicator of how profitable a company is relative to its total assets. - ROA gives a manager, investor, or analyst an idea as to how efficient a company's management is at using its assets to generate earnings. - It takes into account a company's debt, unlike other similar metrics like Return on Equity (ROE). - The higher the ROA the better.
C.	**Leverage Ratio**		- Leverage ratio measures the utilization of borrowed money by the business. It helps to identify the financial stability of the business by analyzing the total debt of the company..
1.	Debt-Equity Ratio (DER)	= Debt / Equity = Long Term Borrowings / Capital	- Debt-equity ratio is the measure of the relative contribution of the creditors and shareholders or owners in the capital employed in business. - This financial tool gives an idea of how much borrowed capital (debt) can be fulfilled in the event of liquidation using shareholder contributions. - A low debt-equity ratio is favorable from investment viewpoint as it is less risky in times of increasing interest rates.
2.	Debt to Asset Ratio	= Total Debt / Total Assets	- This can be used to determine if the business will be able to pay all of its debts if the business is closed immediately. - A company having a debt to asset ratio of less than 1 is considered as good for investment. - If the ratio is greater than 1, the company is considered as highly leveraged.
3.	Debt Ratio (Leverage)	$= \frac{\text{Total Assets}}{\text{Total Equity}}$	- It is one of several financial measurements that look at how much capital comes in the form of debt (loans) or assesses the ability of a company to meet its financial obligations.

4.	Interest Coverage Ratio	$= \frac{\text{[Earnings before Interest and Taxes (EBIT)]}}{\text{Interest Expenses}}$	- This ratio is used to measure the company's ability to meet its interest payment obligation - A higher ratio indicates a better financial position of the business.
5.	Tangible Net Worth (TNW)	= Equity Shareholder's Funds (-) Intangible Assets Or = Total Assets (-) Total Liabilities (-) Intangible Assets	- Tangible net worth is the sum total of one's tangible assets (those that can be physically held or converted to cash) minus one's total debts. - Calculating your tangible net worth involves totaling all your assets- cash, investments, and property and totaling all your secured and unsecured debt, and then subtracting the latter from the former.
6.	Total Liabilities: Total Net Worth (TOL : TNW)	= Total Liabilities/ Total Net Worth	- It is a measure of a company's financial leverage calculated by dividing the total liabilities of the company by the total net worth of the business. - Total outside liability is the sum of all the liabilities of the business and total net worth is the sum of share capital and surplus reserves of the company. - This ratio gives an accurate picture of the businesses reliance on debt. - A low TOL/TNW ratio signifies good levels of promoter's stake in the business, whereas a high TOL/TNW ratio shows low levels of promoter's stake in the business, which is considered risky.
D.	**Activity Ratio**		- Activity ratio indicates the return generated from a particular type of asset using the sales, cost and asset data. - This is also referred to as Efficiency Ratio. - This ratio helps the business to identify effective utilization of the assets and thereby facilitates efficient management.
1.	Receivable Ratio	$= \frac{\text{Annual Sales (Credit)}}{\text{Accounts Receivable}}$	- This measures how soon the firms collect its receivables. - For the ratio calculation, monthly average receivables and sales on credit terms are used generally. - A high receivable ratio indicates the business sales collection process is working well. - Average collection period can also be determined using this ratio.

2.	Inventory Turnover Ratio	$= \frac{\text{Cost Of Sales}}{\text{(Opening stock +Closing stock)/2}}$	- It is a financial ratio showing how many times a company has sold and replaced inventory during a given period. - A slow turnover implies weak sales and possibly excess inventory, while a faster ratio implies either strong sales or insufficient inventory
3.	Total Assets Turnover Ratio	$= \frac{\text{Revenue}}{\text{(Opening Total Assets + Closing Total Assets)/2}}$	- This can be used as an indicator of the efficiency with which a company is using its assets to generate revenue. - The higher the asset turnover ratio, the more efficient a company is at generating revenue from its assets. Conversely, if a company has a low asset turnover ratio, it indicates it is not efficiently using its assets to generate sales. - A company's asset turnover ratio can be impacted by large asset sales as well as significant asset purchases in a given year.