**COMPUTER APPLICATION IN BUSINESS**

**Ratio Analysis**

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Ratio analysis is a quantitative method of gaining insight into a company's liquidity, operational efficiency, and profitability by studying its financial statements. Ratio analysis is a cornerstone of [fundamental equity analysis](https://www.investopedia.com/terms/f/fundamentalanalysis.asp).

### KEY TAKEAWAYS

* Ratio analysis compares line-item data from a company's financial statements to reveal insights regarding profitability, liquidity, operational efficiency, and solvency.
* Ratio analysis can mark how a company is performing over time, while comparing a company to another within the same industry or sector.
* While ratios offer useful insight into a company, they should be paired with other metrics, to obtain a broader picture of a company's financial health

## Ratio Analysis Categories

### Liquidity Ratios

[**Liquidity ratios**](https://www.investopedia.com/terms/l/liquidityratios.asp) measure a company's ability to pay off its short-term debts as they become due, using the company's current or quick assets. Liquidity ratios include the current ratio, quick ratio, and working capital ratio

### The Current Ratio

The current ratio measures a company's ability to pay off its current liabilities (payable within one year) with its current assets such as cash, accounts receivable and inventories. The higher the ratio, the better the company's liquidity position:

Current Ratio = Current assets / current liabilities

### The Quick Ratio

The quick ratio measures a company's ability to meet its short-term obligations with its most liquid assets and therefore excludes inventories from its current assets. It is also known as the "[acid-test](https://www.investopedia.com/terms/a/acidtest.asp) ratio":

Quick ratio=*CLC*+*MS*+*AR*​ / CL

where: *C*=cash & cash equivalents *MS*=marketable securities *AR*=accounts receivable *CL*=current liabilities

### 2. Solvency Ratios

Also called financial leverage ratios, [**solvency ratios**](https://www.investopedia.com/terms/s/solvencyratio.asp) compare a company's debt levels with its assets, equity, and earnings, to evaluate the likelihood of a company staying afloat over the long haul, by paying off its long-term debt as well as the interest on its debt. Examples of solvency ratios include: debt-equity ratios, debt-assets ratios, and interest coverage ratios.

**Debt – Equity Ratio**

Debt-equity Ratio = Long Term Liabilities / Shareholders' funds.

**Shareholders equity ratio**

Shareholders Equity Ratio = Shareholders Funds / Total assets (tangible)

**Capital gearing ratio**

Capital Gearing Ratio = Fixed Int. or Dividend Securities / Eq. S. H. Fund( Net worth)

**Long term funds to fixed assets ratio**

Fixed Assets Ratio = Long term Funds / Fixed Assets

### 3. Profitability Ratios

These ratios convey how well a company can generate profits from its operations. Profit margin, return on assets, return on equity, return on capital employed, and gross margin ratios are all examples of[profitability ratios](https://www.investopedia.com/terms/p/profitabilityratios.asp).

**Gross profit ratio** – It measures the gross margin of profit over the total sales of a unit:

Gross Profit Margin = (Gross profit/ Sales) X 100

**Operating ratio** –Operating ratio is measured to find out proportion of cost of goods sold and operating expenses to sales:

Operating ratio = (Cost of goods sold + Operating expenses / Net Sales) X 100

**Net Profit Ratio** - It measures the margin of revenues available to the owners of the business after satisfying all costs, expense, and losses:

Net Profit Margin = ( Net Profit /Net Sales )X 100

**Return on Capital Employed** - The return on the investment is measured by dividing the net profit or the income by total capital invested:

ROI = ( Net Profit (EBIT) /Capital Employed) X 100

**Return on Equity Shareholders Fund** - This measures returns available for equity shareholders, but it excludes preference share capital

ROESF = ( Net Profit (PAT) – preference Dividend /Equity Shareholders Fund) X 100