Business Growth

Key Financial Ratios

NLOWE

NEWFOUNDLAND & LABRADOR ORGANIZATION OF
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Key Financial Ratios

Financial ratios are an important indicator of a company's fiscal health and value.

These ratios are used by company owners and managers, as well as external investors and regulators to track a company's performance internally and in comparison with competitors.

How is this done?

A financial ratio compares two or more numbers from a company's financial reports to create a 'snapshot in numbers and time' of a company's performance. These snapshots can be weekly, monthly, or year-to-year. By comparing these snapshots to each other over time, owners and investors can spot trends, troubleshoot problems and more accurately forecast projections for future quarters or years.

Some common types and examples of financial ratios:

Leverage Ratios
measure a company's ability to meet its financial obligations

Debt Ratio measures the volume of company assets provided from debt
A high ratio means high debt and could be a sign of financial stress?
Debt Ratio = Total Liabilities/Total Assets

Debt to Equity Ratio measures the total debt and liabilities against shareholder equity.
Bankers use this to monitor a company's capacity to repay its loans and other debt
Debt to Equity Ratio = Total Liabilities/Shareholder's Equity

Liquidity Ratios
measure a company's ability to repay its short and long-term debts

Current or Working Capital Ratio measures ability to repay short-term debt with current assets.
A ratio of 1 or greater is typically acceptable.
Current Ratio = Current Assets/Current Liabilities

Cash Ratio measures ability to repay short-term debt with cash and equivalents
Cash Ratio = Cash and Cash Equivalents/Current Liabilities

Efficiency or Operations Ratios
measure the effectiveness of a company's use of assets and income

The Asset Turnover Ratio measures ability to generate sales from assets:
Asset Turnover Ratio = Net Sales/Average Total Assets

The Inventory Turnover Ratio measures rate that inventory is sold and replaced
Inventory Turnover Ratio = Cost of Goods Sold/Average Inventory

Profitability Ratios
measure a company's ability to generate income compared to its revenue or assets

Gross Margin Ratio shows profit after paying for cost of goods/services sold
Gross Margin Ratio = Gross Profit/Net Sales

Operating Margin Ratio shows operating capacity and efficiency
Operating Margin Ratio = Operating Income/Net Sales

Return on Assets Ratio measures a company's efficiency in generating profits from assets
Return on Assets Ratio = Net Income/Total Assets

Operating ratios analyze efficiency by comparing operating expenses to net sales

Market Value Ratios
evaluate a company's stock value

The Dividend Yield Ratio measures shareholder dividends relative to a share's market value
Dividend Yield Ratio = Dividend Per Share/Share Price

The Earnings Per Share Ratio measures the net income earned for each share outstanding
Earnings Per Share Ratio = Net Earnings/Total Shares Outstanding

Resource:

The Business Development Bank of Canada (BDC) offers Financial Ratio Calculators on its website: https://www.bdc.ca/en/articles-tools/entrepreneur-toolkit/financial-tools

Sources:

https://corporatefinanceinstitute.com/resources/knowledge/finance/financial-ratios/

https://www.bdc.ca/en/articles-tools/money-finance/manage-finances/financial-ratios-what-are-how-use