

<A>Appendix A: Commonly Used Financial Ratios<A>

Financial Ratio (How Measured)	Formula	Interpretation
<u>Liquidity Ratios:</u>		
Current Ratio (Decimal)	Current Assets/Current Liabilities	Indicator of firm's ability to pay its short-term liabilities
Quick (Acid-Test) Ratio (Decimal)	$\frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$	Measures firm's ability to pay off short-term liabilities from current assets excluding inventories
<u>Profitability Ratios:</u>		
Net Profit Margin (%)	Net Profits After Taxes/Net Sales	Indicates after-tax profits produced by each dollar of sales
Gross Profit Margin (%)	$\frac{\text{Net Sales} - \text{Cost of Sales}}{\text{Net Sales}}$	Margin available to cover expenses other than the cost of sales while still providing a profit.
Return on Investment (%)	$\frac{\text{Net Profit After Taxes}}{\text{Total Assets}}$	Indicates return on the firm's total assets; it shows how efficiently the firm is using its assets regardless of how they are financed.
Return on Equity (%)	Net Profit After Taxes/Shareholders' Equity	Measures return on book value of shareholders' total investment in the firm
Earnings Per Share (Dollars Per Share)	$\frac{\text{Net Profit After Taxes} - \text{Preferred Dividends}}{\text{Average Number of Common Shares}}$	Measures after-tax earnings produced for each share of common stock outstanding

Appendix A (Continued)

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Financial Ratio (How Measured)	Formula	Interpretation
<u>Activity Ratios:</u>		
Inventory Turnover (Decimal)	Net Sales/Inventory	Indicates number of times average inventory is sold during a particular time period
Days in Inventory (Days)	Inventory/Cost of Goods Sold/365	Indicates number of days of inventory a firm has on hand at a particular time
Asset Turnover (Decimal)	Net Sales/Total Assets	Measures firm's utilization of its assets and net sales generated by each dollar of assets
Average Collection Period (Days)	Accounts Receivable/Annual Sales/365	Average number of days a firm must wait to receive payment after a sale is made
Accounts Payable (Days)	Accounts Payable/Annual Purchases/365	Indicates average length of time in days the firm takes to pay its suppliers
<u>Leverage Ratios:</u>		
Debt-to-Equity Ratio (%)	Total Debt/Shareholders' Equity	Measures funds provided by creditors versus those provided by shareholders
Long-Term Debt to Total Capital (%)	$\frac{\text{Long-Term Debt}}{\text{Shareholders Equity} + \text{Long-Term Debt}}$	Measures share of total financing received from long-term creditors
Times Interest Earned (Decimal)	$\frac{\text{Earnings Before Taxes} + \text{Interest Expense}}{\text{Interest Expense}}$	Measures firm's capacity to pay its interest expense
Fixed Charge Coverage Ratio (Decimal)	$\frac{\text{Profit Before Taxes} + \text{Interest Expense}}{[\text{Profit Before Taxes} + \text{Interest Expense} + \text{Principal Repayment} \times (1/(1 - \text{Tax Rate}))]}$	Indicates firm's ability to repay all fixed obligations

