Financial Ratio Analysis

Summary Overview "Cheat Sheet" by MBAbullshit.com

- It's not enough to simply say a company is in "good or bad" health…

- We put numbers on this "health," so that we can compare these "health numbers" with the numbers of other companies…

- One form of "health numbers" are "ratios" which is basically different numbers combined into just one number to make it "simpler."

- For example, if a company has current assets of $1,000 (one number) and current liabilities of $800 (another number), these two numbers can be combined $1,000/$800 into just one number of 1.25 (1000/800=1.25) which in this example is the "current ratio."

- Of course, because of this "1-number simplicity," it doesn't tell the 'whole story' and they are not completely reliable. There are many flaws and many different ways of understanding individual financial ratios, which I cover deeply on both my FREE & premium videos at MBAbullshit.com

- Liquidity Ratios can tell us how easily a company can pay its debts… so that the company doesn't get eaten up by banks or other creditors. An example is the Current Ratio (as above).

- Profitability Ratios can tell us how good a company is at making money. An example of this is the Profit Margin Ratio.

- Leverage ratios tell us how much debt the company is using to make the company run and stay alive. An example of this is the simple Debt Ratio.

- See a **Super Summary** of 8 Common Financial Ratios on next page:

[Current Ratio](): (Current Assets)/(Current Liabilities)

- Tells us how much of your company's stuff can be easily changed into cash within the next 12 months so that it can pay debts which need to be paid also within 12 months.
- A higher ratio (significantly above 1) indicates that the company is "less risky" for creditors, but could also indicate that the company is not efficient at using current assets for more profit.

[Quick or Acid Test Ratio](): (Quick Assets)/(Current Liabilities)

- Tells us how much assets can be easily and quickly converted to cash to pay for liabilities within the next 12 months.
- Similar to current ratio, a higher number indicates that the company is "less risky" for creditors, but could also indicate that the company is not efficient at using short term assets for profit.

[Cash Ratio](): (Cash/Current Liabilities)

- Similar to the current ratio and even more stringent than the Quick Ratio, as we only compare cash with current liabilities instead of all current assets to current liabilities. Why? Because you cannot easily use all of your current assets to pay your debts.

[ROA]() or [Return on Assets](): (Net Income)/(Total Assets)

- Higher ROA indicates that the company is more efficient in using assets to generate profit; a lower ROA indicates that the company is less efficient in using assets to generate profit.

[ROE]() or [Return on Equity](): (Net Income)/(Total Equity)

- A higher ROE indicates that the company is more efficient in giving more profit to the company's owners compared to these owners' personal investment in the company.

[Profit Margin Ratio](): (Net Income)/(Sales)

- Tells us how much profit your company earns compared to your company's sales. Normally, a higher number is better; because you want to earn more profit for every $1 of sales that you get.

[EPS]() or [Earnings Per Share](): (Net Income)/(# Shares Outstanding)

- Tells us how much proportion of income the holder of one share of stock is entitled to. VERY UNRELIABLE ratio because even companies of same size or profitability may have different number of outstanding shares.

[P/E]() or [Price Earnings Ratio](): (Share's Market Price)/(Earnings Per Share)

- A low Price Earnings Ratio can be good because it means the market price is low compared to how much profit the company is making; but can also be bad because "why is it selling cheap?" Maybe they're expecting bad news in the future.

To understand these ratios in better detail, watch my FREE videos at [MBAbullshit.com]()