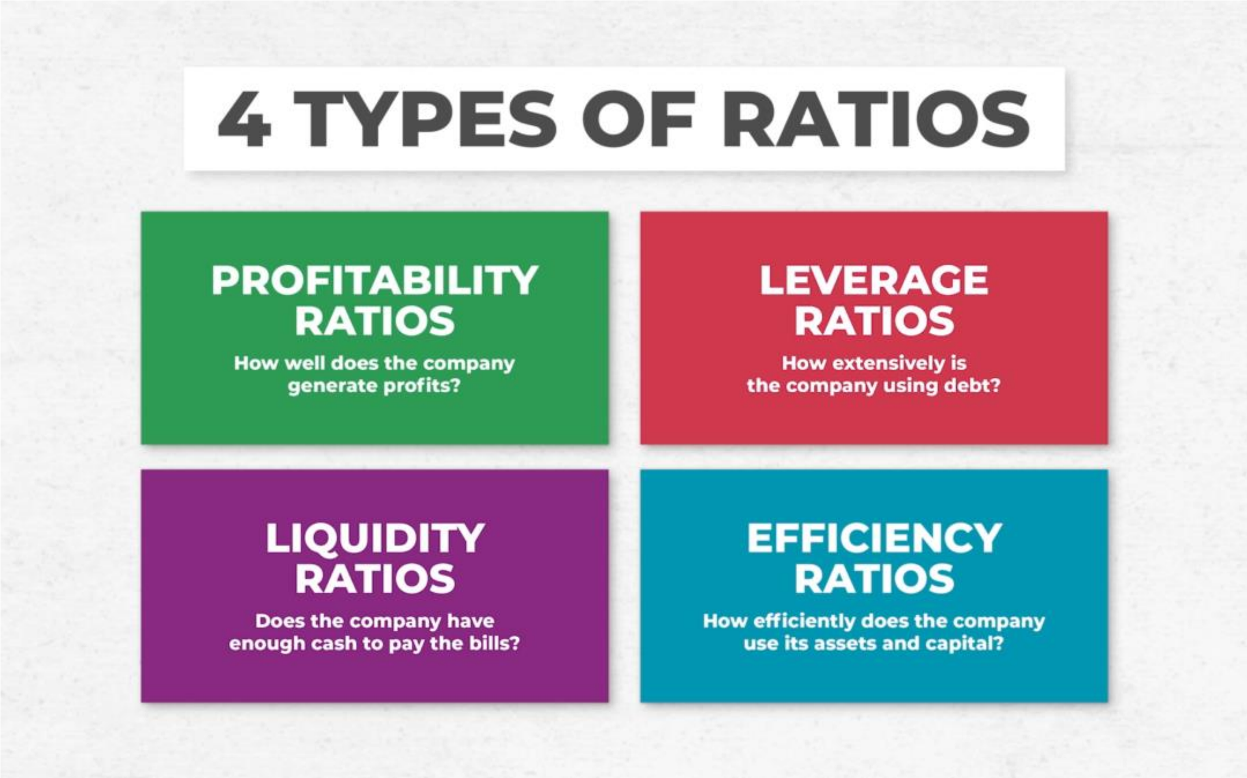
1/ Strategic Benefits of a Ratio Analysis

Managers can make informed strategic decisions with insights from a financial ratio analysis. Whether optimizing asset utilization, adjusting pricing strategies, or restructuring debt, it provides a factual basis for strategic planning. Understanding and applying ratio analysis types can radically transform your business strategy in several ways:

- **Informed Decision-Making:** Key ratios in financial analysis provide a quantitative foundation for strategic decisions, enhancing their accuracy and effectiveness.
- **Operational Improvements:** Identifying inefficiencies through important ratios for financial analysis enables you to streamline operations, optimize asset utilization, and improve profitability.
- **Competitive Benchmarking:** Comparing your business financial ratios with industry averages helps you understand your competitive position and identify areas for strategic enhancement.

2/ TYPES OF RATIOS

It is about turning insights into actions that enhance financial performance and competitive positioning.



The raw numbers reported on a company's financial statements are informative, but to unlock insights, spot trends, and compare against competitors, you have to look at the relationship between those numbers. That's where financial ratios come in. There are four types of financial ratios, each of which tells a different part of a company's financial story.

The Basics

- Ratios tell a more complete story about a company's financial health than numbers alone.
- Financial ratios are a comparison between two numbers that can reveal how a company operates, aspects of its financial health, and how it stacks up against competitors.
- There are four types of financial ratios: profitability, leverage, liquidity, and efficiency ratios.

A financial ratio is simply the relationship between two numbers taken from a company's financial statements. You generate a ratio by dividing one number by the other. Ratios will sometimes use numbers from the same statement—the income statement, for example—or from different statements.

There are four types of financial ratios:

1. Profitability ratios tell you how well a company is producing profits
2. Leverage ratios tell you how extensively the company uses debt
3. Liquidity ratios tell you if the company has enough cash to cover its bills
4. Efficiency ratios tell you how efficiently the company uses its assets and capital.

Different ratios tell you different things, which means that a high ratio isn't necessarily good or bad. For some measures, a high ratio is desirable; for others, a low ratio is desirable.

2.1 / Profitability ratios

These ratios use numbers on the income statement to give you a picture of how well a company is doing at taking things like revenue, assets, operating costs, and equity and turning them into profit.

A/ Gross profit margin ratio

Gross profit margin is the ratio of gross margin to net sales, expressed as a percentage. This ratio answers the question: For every dollar of sales, how much do we make after paying for the ingredients and costs directly associated with making the product?

Gross profit margin percentage = (Gross margin / Net sales) x 100%

In this equation:

- **Gross profit** is the difference between net sales and the cost of net sales.
- **Net sales** is the company's total revenue from sales minus returns and discounts.

The gross profit margin ratio is a key indicator for how much profit a company makes from what it sells, given the cost of making their product. Generally, the higher the gross profit margin percentage, the better a company is at turning sales into profits.

B/ Operating profit margin ratio

Operating profit margin is the ratio of operating income to revenue, expressed as a percentage. This ratio answers the question: For every dollar of sales, how much money do we have left over after paying for materials and overhead?

Operating profit margin percentage = (Operating income / Net sales) x 100%

In this equation:

- **Operating income** is a company's total revenue minus COGS (cost of goods sold) and operating expenses.
- **Net sales** is the company's total revenue from sales minus returns and discounts.

The operating margin ratio is a key indicator for how well a company can earn profits from its core product or service offering. Generally, the higher the ratio, the better a company is at turning sales into profits.

While this ratio is similar to the gross profit margin ratio in that both measure how profitable a company is, gross profit margin subtracts costs associated with production and distribution, whereas operating profit margin subtracts additional costs: COGS and operating expenses. Non-operating expenses like taxes and interest are still not accounted for—but they will be in the next ratio.

C/ Net profit margin ratio

Net profit margin is the ratio of net income to net sales, expressed as a percentage. This percentage answers the question: For every dollar of sales, how much money do we have left over after paying for everything, including interest and taxes?

Net profit margin percentage = (Net income / Net sales) x 100%

In this equation:

- **Net income** is a company's total profits after subtracting the cost of all of its expenses from revenue generated over a reported period of time.
- **Net sales** is the company's total revenue from sales minus returns and discounts.

The net profit margin percentage is a key indicator of how much money the company is making when all is said and done. A higher percentage means a healthier business and happier shareholders, since this is the money that can be reinvested in the business or paid to shareholders in the form of dividends.

D/ Return on assets percentage

Return on assets is the ratio of net income to assets, expressed as a percentage. This ratio answers the question: For every dollar tied up in your business, how much comes back as profit?

Return on assets percentage = (Net income / Assets) x 100%

In this equation:

- **Net income** is a company's total profits after subtracting the cost of all of its expenses from revenue generated over a reported period of time.
- **Assets** are everything you've got invested in your business, including cash, equipment, factories, offices, or other real estate.

The return on assets ratio is a key indicator of whether a company is using its assets well; in other words, how profitable a company is, according to its assets.

E/ Return on equity percentage

Return on equity is the ratio of net income to shareholder's equity, expressed as a percentage. This percentage answers the question: For every dollar that shareholders invest in the company, how much is coming back as profit?

Return on equity percentage = (Net income / Shareholders' equity) x 100%

In this equation:

- **Net income** is a company's total profits after subtracting the cost of all of its expenses from revenue generated over a reported period of time.
- **Shareholders' equity** is total assets minus total liabilities.

While a high return on equity will make shareholders happy, it can also indicate that the company is taking out loans to finance their business, and thus may have an unreasonable amount of debt.