

Ratio Formulas by Chapter

This is a summary of the ratios introduced in each chapter using a hierarchical approach to analyzing financial statements. See “*What Do I See?*” scenic videos for help in finding related information within a company’s report. See “*How Do I Use the Numbers?*” videos for insights in interpreting the ratios.

Balance Sheets- hierarchical ratio analysis

Financial leverage¹ = *total liabilities/total assets*

Working capital = *current assets – current liabilities*

Current ratio = *current assets/current liabilities*

Market-to-book ratio² = *(market price per share x outstanding shares)/book value of owners' equity*

- 1 There is no universally accepted measure for financial leverage. Typically, it’s measured using one of the following: liabilities / assets, assets / owners’ equity, or liabilities / owners’ equity, also called debt-to-equity ratio. The financial leverage numbers differ for the formulas, but the conclusions you draw when comparing financial leverage across companies (or over time for the same company) will be the same, providing you use the same formula for all computations.
- 2 Market price per share may be reported in the company’s footnotes or obtained on a variety of internet sites, such as BigCharts.com. Use the historical stock price as of the balance-sheet date.



Income Statements- hierarchical ratio analysis

ROE-CI = *comprehensive income / average owners' equity*

ROE (Return on Equity) = *net profit / average owners' equity*

ROE-OCI = *other comprehensive income / average owners' equity*

DuPont Model ROE = *profit margin x asset turnover x financial leverage x income tax factor*

Profit margin = *pretax profit / revenues*

Asset turnover = *revenues / average assets*

Financial leverage = *average assets / average owners' equity*

Income tax factor = $1 - (\text{tax expense} / \text{pretax profit})$

EPS (earnings per share)¹ = *net profit / average number of shares outstanding during period*

Profit margin = *pretax profit / revenues*

Operating profit margin = *operating profit / revenues*

Non-operating profit margin = *non-operating profit / revenues*

Gross margin = *(revenues – cost of sales) / revenues*

Net profit margin = *net profit / revenues*

1 Any preferred stock dividends are subtracted from net profits. Companies often disclose basic and diluted earnings per share. Diluted earnings per share is computed by dividing by the diluted average shares outstanding. This computation adjusts the denominator in the basic earnings per share computation for items such as outstanding stock options, convertible debt, or other financial instruments that could be converted to common stock, and thus, increasing the common shares outstanding and diluting (decreasing) earnings per share.