

## Ratios and Reports: Beyond the Financial Statements

In addition to the traditional financial statements, you will want industry specific reports to allow you to compare your company's performance to that of others. You will also want to learn the key ratios and the value of those ratios in month-to-month and year-to-year comparisons of your company's performance.

Here are several key ratios and trend indicators. Keep in mind that a change in one of these indicators from one accounting period to another, or a significant difference between your company and the industry average, is what makes the measurement useful. Check these ratios and reports to see which ones are the best for monitoring your company's performance.

### Net profit margin

In its simplest form, this is net income divided by sales. Every manager wants to know if his or her business can do better and how the business compares with similar businesses in the industry and in the community. When comparing your company to its past performance, an upward trend in this ratio is certainly desirable.

### Inventory turnover ratio

This is the cost of goods sold for the accounting period divided by the average of inventory at the beginning and end of the accounting period. This ratio is an excellent indicator of trends in sales volume. Assuming the same price markup on your products, the higher your inventory turnover ratio, the better.

### Accounts receivable turnover ratio

This is compared by dividing the credit sales for the accounting period by the average of the outstanding accounts receivable at the beginning and the end of the accounting period. These numbers are most useful when compared to industry standards and your own company's past performance. You should also prepare an accounts receivable aging list. This tracks the balances in the 30-day-old, the 60-day, and the 90-day-or-older categories. In general, the older the account receivable, the less likely you are to collect it. This is one set of numbers your banker will want to see when you ask for additional operating funds.

### Current ratio

This is the total current assets divided by total current debts. This ratio measures your business's ability to pay off all its current obligations (due in one year or less) with your current assets which can be turned into cash in a short time). Current ratios of 2 to 1 are desirable. A ratio of less than one means that you company could be hard pressed to meet obligations such as payroll and current accounts payable.

### Quick ratio

This is also known as the acid test ratio. This is cash, collectible receivables, and marketable securities divided by current liabilities. This means you would not need to sell inventory to meet current debts. A quick ratio of one or greater should keep your company operating smoothly.

### Debt-to-equity ratio

The debt-to-equity ratio is of special interest to your creditors. The ratio is computed by dividing the total debt of the company by the total equity (net worth). For example, if the net worth was \$100,000 and the debts were \$150,000, your debt-to-equity ratio would be 1.5. A healthy ratio would normally be something less than 2.0, and even better at 1.0. You should compare your company to others in your industry.

### Breakeven point

The breakeven point is probably one of the most watched numbers in any business. This is the point at which the revenue exactly matches costs, the point at which there is no profit and no loss. It can be expressed in dollars or units of product. You may find yourself monitoring the breakeven daily, monthly and yearly. Once you pass the breakeven point, the gross profit on additional sales should all become part of the net profit.

Please contact our office and we will gladly discuss the financial information that you can use to enhance the profitability of your business.