Financial Analysis Fundamentals
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Vertical and Horizontal Income Statement Analysis
Session objectives

- Learn the key components of the income statement
- Benchmark against other companies in the industry
- Perform vertical and horizontal analysis
Financial analysis

There are many important steps, such as trend and ratio analysis, in preparing a financial analysis. The starting point is the financial statements:

- Income statement
- Balance Sheet
- Statement of Cash Flows
There are many important steps, such as trend and ratio analysis, in preparing a financial analysis. The starting point is the financial statements:
Ratio analysis covers two basic groups.
When analysing the income statement, we use performance ratios – specifically those related to profitability.
A breakdown of the income statement

<table>
<thead>
<tr>
<th>Tensel</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenues</td>
<td>81,422</td>
<td>84,698</td>
<td>88,236</td>
<td>90,637</td>
</tr>
<tr>
<td>COGS/COS</td>
<td>(38,121)</td>
<td>(37,756)</td>
<td>(36,327)</td>
<td>(42,938)</td>
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<tr>
<td>Gross profit</td>
<td>43,301</td>
<td>46,942</td>
<td>51,909</td>
<td>47,699</td>
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<tr>
<td>Research and development</td>
<td>(5,884)</td>
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<tr>
<td>Marketing</td>
<td>(23,507)</td>
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<tr>
<td>Sales</td>
<td>(1,764)</td>
<td>(1,931)</td>
<td>(2,530)</td>
<td>(2,563)</td>
</tr>
<tr>
<td>General and administration</td>
<td>(2,960)</td>
<td>(2,803)</td>
<td>(2,762)</td>
<td>(2,947)</td>
</tr>
<tr>
<td>EBIT (operating profit)</td>
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<td>8,992</td>
<td>5,368</td>
</tr>
<tr>
<td>Interest</td>
<td>(1,073)</td>
<td>(1,102)</td>
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**Sales revenues** are the most important components of the income statement and are used in several of the ratios seen throughout the module.

**Cost of good sold** relates to direct labor and raw materials needed to create the product or service that is being sold, as well as depreciation on manufacturing equipment used in production.

**Gross profit** tells us what the gross margin is before we take into account any other costs needed to keep the company running.

**Indirect expenses** are those required to keep the company going. The most common are: research & development, marketing, sales, and general & administration.

**Operating income** is used to pay the government, creditors, and ultimately the shareholders.

**Net income** is the final part of the income statement and represents what is remaining to be paid to the shareholders.
Vertical analysis

- Net income
  - Sales
  - Tax
    - Sales
  - Operating income
    - Sales
- Operating costs
  - Sales
- Gross profit
  - Sales
- R&D
  - Sales
- Personnel costs
  - Sales
- Selling costs
  - Sales
- Admin costs
  - Sales
- Labor costs
  - Sales
- Material costs
  - Sales
- Work overhead
  - Sales
Gross profit margin

There are three key profitability ratios:

\[
\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Sales}} \times 100\%
\]
Operating profit margin

\[
\text{Operating profit margin} = \frac{\text{EBIT}}{\text{Sales}} \times 100\%
\]
Net profit margin

Net income / Sales = Net profit margin (%)
Efficiency ratio

The tax ratio is the efficiency ratio that demonstrates how well managing tax.

\[
\text{Tax ratio} = \frac{\text{Tax expense}}{\text{Pre-tax income}}
\]
The interest coverage ratio tells us whether the company will be able to cover what it owes in interest to its creditors.

\[
\text{Interest coverage ratio} = \frac{\text{EBIT(DA)}}{\text{Interest expenses}}
\]
### Horizontal analysis

Use calculations from the past five years to perform trend analysis and predict future performance.

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Horizontal analysis
Benefits of horizontal analysis

Are margins rising or failing?
Is performance improving or declining?
What is causing margins to fall?
Are margins impacted by indirect costs?
Benchmarking

There are different ways to benchmark:

- Compare your company to two or more competing companies
- Compare your company’s ratios to the industry average
Sources of benchmarking information

Where can you find a competitor’s statements?

- Three key online sites including EDGAR, SEDAR and RNS
- Competitors’ investor relations websites

Historical ratios for companies can be found on MSN Money and Google Finance, but allow very little control over the information and provide little insights on the calculation of ratios.

Professional sources such as Bloomberg, Capital IQ, and equity research reports provide detailed information but are more costly.
Conclusion

Income statement analysis is just the first step to the overall analysis.

Understand past performance, to predict future success.

Use vertical and horizontal analysis, as well as benchmarking, to maximize your company's performance.

Make better investment and credit decisions from outside the company.
Balance Sheet and Leverage Ratios
Session objectives

Determine the financial strength of a company by analyzing the balance sheet

Use the balance sheet to determine how efficiently a company is being run
Financial analysis

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There are many important steps, such as trend and ratio analysis, in preparing a financial analysis. The starting point is the financial statements:

- Financial analysis
  - Interpret financial results
  - Trend and ratio analysis
  - Financial statements
    - Pyramid ratio analysis
    - Basic ratio analysis
    - Using ratio analysis
Components of ratio analysis

Ratio analysis covers two basic groups:

- Performance ratios
- Financial leverage ratios
- Profitability ratios
- Liquidity ratio
- Efficiency ratios
- Solvency ratio
Short term liquidity ratios

1. Current ratio
2. Quick ratio
Current ratio

Generic rule of thumb is 2:1

Current assets

Current liabilities
Quick ratio or acid test ratio

\[
\text{Current assets} - \text{Inventory} \quad \text{Current liabilities}
\]

Generic rule of thumb is 1:1
Asset turnover ratio

\[
\frac{Sales\ Revenue}{Total\ (or\ net)\ Assets}
\]

Tells us:

How efficient is the company in using assets to generate revenue?

For every 1 dollar of assets, how many dollars of revenue the company generates?
Conclusion

Always use trend analysis to determine:

- What are the ratios doing?
- Are they improving or deteriorating?

Short term liquidity ratios are an early warning signal to cash flow issues.
Working capital overview

Working capital

Current Asset – Current Liabilities
Working capital overview

Working capital

Inventory

Receivables

Payables

Operating activities
Working capital overview

Working capital

Accounts receivable + Inventory − Accounts payable

Operating activities
Working capital funding gap

- Company buys inventory
- Company pays for inventory
- Company sells goods
- Customer pays for goods

Payables → Inventory
Inventory → Receivable
Cash out → Working Capital Funding Gap → Cash in
Working capital funding gap

What would happen to the working capital funding gap?

Increase  Decrease

Company buys inventory  Company pays For inventory  Company sells goods  Customer pays for goods

Cash out  Working capital funding gap  Cash in

inventory  Receivable  Payables
Working capital funding gap

Company buys inventory

Company pays for inventory

Company sells goods

Customer pays for goods

Payables

Inventory

Receivable

Working capital funding gap

Cash out

Cash in

Delay company payments

Faster customer payments

"Just-in-time"
The working capital efficiency ratios

2

Ratios for each Inventory, Accounts receivable, Accounts payable + Working capital efficiency ratio
Inventory efficiency ratios

- **Inventory turnover ratio**: \(\frac{\text{Cost of sales}}{\text{Inventory}}\)
- **Inventory days ratio**: \(\frac{\text{Inventory} \times 365}{\text{Cost of sales}}\)
Accounts receivable

Accounts receivable efficiency ratios

- Receivable turnover ratio: \( \frac{Sales}{Accounts \ rec.} \)
- Receivable days ratio: \( \frac{Accounts \ rec. \times 365}{Sales} \)
Accounts payable

Accounts payable efficiency ratios

1. Payable turnover ratio
   \[
   \frac{\text{Cost of sales}}{\text{Accounts pay.}}
   \]

2. Payable days ratio
   \[
   \frac{\text{Accounts pay.} \times 365}{\text{Cost sales}}
   \]
The funding gap

Inventory days plus accounts receivable days minus accounts payable days will leave you with the working capital funding gap expressed as days.

+60
Company buys inventory

-30
Company pays for inventory

+30
Company sells goods

Customer pays for goods

Payables

Inventory

Working capital funding gap

Cash out

Receivable

Cash in

=60
PP&E efficiency ratio

Property, plant and equipment ratio

\[
\text{Sales} \div \text{PP&E} = \text{PP&E turnover ratio}
\]

If the ratio is comparatively low, it means either sales are low or you have invested too much in PP&E.
Conclusion

Financial analysis is important in understanding a company's financial condition and performance.

Use in conjunction with information from the income statement to gain valuable company insights.

With ratio and trend analysis you can build expectations of future performance.

Performance can be improved to increase operational efficiencies.

corporatefinanceinstitute.com
Cash Flow Statement and Ratios
Session objectives

Understand the inflows and outflows of cash throughout the year

Calculate solvency and leverage ratios

Examine funding options for an organization looking to grow
Financial analysis

There are many important steps, such as trend and ratio analysis, in preparing a financial analysis. The starting point is the financial statements:

- Income statement
- Balance Sheet
- Statement of Cash Flows
Analyzing cash flow groups

Cash flow

Asset management
- Asset management relates specifically to the management of investment in the company and is where commitment to growth can be seen.
  - Working capital
    - Absorbing
    - Releasing
  - Capital expenditure
    - >amortization
    - <amortization
  - Acquisitions

Operational management
- Operational management refers to the operational strategy followed by an organization.
  - Margin management
  - Volume management
  - Operating profit

Financing strategy
- Financing strategy reflects decisions made by management in relation to the “leverage” of the company.
  - Debt / Equity
  - Long-term / Short-term
  - Other instruments
  - Interest / Dividends

Each category of the statement of cash flows enables you to analyze the movement of funds in the company.
Understanding debt

There are many options available when looking for debt financing:

- Overdraft
- Operating line of credit
- Term loans
  - Working capital funding gap
  - Purchase assets
Debt financing

- Bonds are a common form of debt financing
- The normal contract with rate of interest is called the “coupon”
- Issuing bonds is a common method of raising funds
- Most useful in funding long-term investments

A bond is a debt instrument requiring the issuer (also called the debtor or borrower) to repay to the lender/investor the amount borrowed plus interest over some specified period of time.

Source: Frank Fabozzi Bond Market analysis & strategies
Types of bonds

**Fixed rate**
- Have coupons that remain constant throughout the life of the bond

**Floating rate**
- Have coupons linked to an interest rate benchmark
- Coupon reset periodically (e.g. every 3 months)

**Zero coupon**
- Pay no interest
- Trade at a discount from their value at maturity

**Inflation-linked**
- Principal amount indexed to inflation
- Interest rate is fixed, but principal and interest payments grow

**Callable**
- The issuer has the right to repay the bond before the maturity date

**Convertible**
- Can be converted into shares of stock in the issuing company
Warrants and convertibles compared

**Bonds with warrants**
- Tend to be more common in private placements
- The warrant can be detached
- Warrants are exercised for cash

**Convertible bonds**
- Convertible bonds are issued publicly
- The bond and the option are bundled together
- Bonds are exchanged for common stock
### Types of syndicated loans

Syndicated lending is where two or more banks provide credit to one borrower in one agreement.

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Term loans</strong></td>
<td>A loan with a fixed maturity and normally featuring the amortization of principal</td>
</tr>
<tr>
<td><strong>Revolving credit facilities</strong></td>
<td>Offering the borrower the right, but not the obligation to draw a loan</td>
</tr>
<tr>
<td><strong>Standby facilities</strong></td>
<td>Lines only expected to be used in extraordinary circumstances (e.g. commercial paper backup)</td>
</tr>
</tbody>
</table>
Leasing as an option

When an asset is leased, it remains the property of the lessor. Different accounting standards treat leases differently depending on how the lease is structured.

**Capital (finance) lease**
- Usually longer term; most of the risks and rewards of ownership transfer to lessee
- Recorded on balance sheet

**Operating lease**
- Usually shorter term; risks and rewards do not transfer to the lessee
- Recorded in income statement

(corporatefinanceinstitute.com)
Leasing as an option

A capital of finance lease is a way to borrow funds for assets directly through the assets’ owner.
Leasing as an option

An operating lease is a way to obtain use of an asset until it is no longer required or useful.
Who can tap into the debt markets

To raise debt financing...
- Show a history of profitability
- Have assets that can be pledged as security

If a company is not yet profitable...
- Raise equity financing
- Dilute the existing shareholder to raise capital
Equity consist largely of common shares. Ownership of common shares normally entitles the holder to:

- **Voting rights**: A right to vote on appointments to the board of directors.
- **Ownership**: An equal share in earning after obligations to debt holders and preferred stockholders are met.
- **Residual claim**: A residual claim on the business and therefore have the ultimate control of the company’s affairs.
Equity types – preferred share varieties

- **Cumulative**
  - Entitle holder to fixed rate of dividend and if unpaid arrears cumulate

- **Participating**
  - Have extra rights. In addition to receiving fixed dividend also participate in company’s surplus profit

- **Convertibile**
  - Right to convert the preferred stock into common stock at a specified future date at a specified rate of conversion

- **Redeemable**
  - Will be redeemed at a specified future date at the option of either the company of the shareholder

- **Retractable**
  - Right to “retract” the share and pay the owner in cash at a specified price at maturity
Retained earnings

Equity

Share capital

Retained earnings

Profit

Dividends
Leverage expresses the relationship between funding provided by lenders and funding provided by shareholders.

High leverage

- 20 Equity
- 80 Long and short term debt

Capital employed (100)

Low leverage

- 80 Equity
- 20 Long and short term debt

Capital employed (100)
Growing the business using debt

- **Investment in assets**
  - Invest in PP&E
  - Increase cash working capital
Growing the business using debt

This is how you increase the leverage of the company by increasing debt rather than equity.
The benefits of leverage

Leverage is effective for a number of reasons:

**Reason 1**
It is often very quick and inexpensive to obtain a loan of extension of a line of credit from the bank.

**Reason 2**
A short term line of credit may be ideal for increasing inventory for a seasonal business, and a long term fixed payment loan for a significant investment in equipment to be used to increase production over a longer time period.

**Reason 3**
Increasing debt the current shareholders can increase the value of the company without having to reduce their share of the company.

**Reason 4**
If a company requires a large amount of funds intended for long term use and investment in the company, a share offering may be the best option.
An effective capital structure

<table>
<thead>
<tr>
<th>Cost</th>
<th>Leverage %</th>
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<tbody>
<tr>
<td>%</td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>40 %</td>
</tr>
<tr>
<td>Debt</td>
<td>60 %</td>
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Debt is expensive
An effective capital structure

- Pay out more dividends
- Buy back shares

- Cost of funds
- Firm value
- Cost %
- Leverage %

- Debt
- Equity
An effective capital structure

- **Firm value**
- **Debt**
- **Equity**

Debt is expensive

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An effective capital structure

- **Equity**
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Firm value

"Sweet spot"

Cost of funds

- **Debt**
- **Equity**
Leverage ratios

There are several different ratios to use in order to assess the leveraging of a company:

1. **Debt to equity (or debt to capital):**
   \[
   \text{Debt to equity} = \frac{\text{Interest bearing liabilities}}{\text{Total shareholder's equity}}
   \]
   - If the ratio is greater than 100%, more of an organization's funding comes in the form of debt rather than equity.

2. **Debt to TNW*:**
   \[
   \text{Debt to TNW} = \frac{\text{Interest bearing liabilities}}{\text{Equity} - \text{Intangible assets}}
   \]
   - A ratio of 1 would be reasonable, but if it's greater than 1, then attention should be paid to how a company is managing its financing activities.

3. **Total liabilities to equity:**
   \[
   \text{Total liabilities} = \frac{\text{Total liabilities}}{\text{Equity}}
   \]
   - The ratio would be used with conjunction with the debt to equity ratio to determine the impact that operational liabilities has on the funding of the business.

4. **Total assets to equity:**
   \[
   \text{Total assets} = \frac{\text{Total assets}}{\text{Equity}}
   \]
   - If the ratio is low, the company may be underleveraged. If the company number is high, then the organization, while taking advantage of debt, may be over-leveraged.

5. **Debt to EBITDA:**
   \[
   \text{Debt to EBITDA} = \frac{\text{Interest bearing liabilities}}{\text{EBITDA}}
   \]
   - This ratio is used to assess the amount of leverage relative to EBITDA, this ratio is commonly used by lenders. Can range by industry from 1 – 5 times.
Conclusion

- Analyze how management is raising and using funds by reviewing cash flow of the business.
- Understand how leverage can be altered using a variety of debt and equity options.
- Describe all the benefits and possible pitfalls of leverage.
- The cash flow analysis is one side of the pyramid of ratios found in Module 4.
Rates of Return and Profitability Analysis
Session objectives

Use the pyramid of ratios to explain what drives a company’s financial performance
Financial analysis

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There are many important steps, such as trend and ratio analysis, in preparing a financial analysis. The starting point is the financial statements:
Return on Equity (ROE)

\[
\text{Return on Equity (ROE)} = \frac{\text{Net income}}{\text{Shareholder's equity}}
\]
Financial metrics

Financial Analysis
Module 1 – Analyzing the income statement

Financial Analysis
Module 3 – Funding the business

Return on equity
ROE levers

Return on equity = Net profit margin \times \text{Total asset turnover} \times \text{Financial leverage}

\[
\frac{\text{Net income}}{\text{Equity}} = \frac{\text{Net income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total assets}} \times \frac{\text{Total assets}}{\text{Equity}}
\]
ROE levers

\[
\frac{\text{Net income}}{\text{Equity}} = \frac{\text{Net income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total assets}} \times \frac{\text{Total assets}}{\text{Equity}}
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ROE levers

Return on equity = Net profit margin × Total asset turnover × Financial leverage

Net profit margin = Net income / Sales
ROE levers

Return on equity = \(\frac{\text{Net income}}{\text{Equity}}\)

Net profit margin = \(\frac{\text{Net income}}{\text{Sales}}\)

Total asset turnover = \(\frac{\text{Sales}}{\text{Total assets}}\)

Financial leverage = \(\frac{\text{Total assets}}{\text{Equity}}\)

Total asset turnover = Sales / Total assets
ROE levers

\[
\text{Return on equity} = \frac{\text{Net income}}{\text{Equity}} = \frac{\text{Net income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total assets}} \times \frac{\text{Total assets}}{\text{Equity}}
\]

Financial leverage = Total assets / Equity
The Dupont analysis

- **ROE**
  - Assets / Equity
  - Sales / Assets
  - EBIT / Sales
  - Pretax profit / EBIT
  - Net income / Pretax profit

- Leverage equity
- Volume impact
- Margin impact
- Capital structure impact
- Tax impact
Secondary profitability ratios

\[ \text{Net Profit Margin} \times \frac{\text{Net income}}{\text{Pretax profit}} \times \frac{\text{Pretax profit}}{\text{EBIT}} \times \frac{\text{EBIT}}{\text{Sales}} \]

- Tax impact
- Capital structure impact
- Margin impact
Secondary profitability ratios

If taxes are zero, these two values would be equal, and the ratio would equal one.

\[
\frac{\text{Net income}}{\text{Pretax profit}} = \text{Tax impact}
\]

If debt is zero, these two values would be equal, and the ratio would equal one.

\[
\frac{\text{Pretax profit}}{\text{EBIT}} = \text{Capital structure impact}
\]

\[
\frac{\text{EBIT}}{\text{Sales}} = \text{Margin impact}
\]
Secondary efficiency ratios

Total asset turnover

- Sales / Working capital
- Sales / PP&E
Secondary efficiency ratios

At the time of initial investment, the ratio will be driven down and will improve over time.

- **PPE turnover**
  \[
  \frac{Sales}{PP&E}
  \]
  = PPE turnover

- **Working capital turnover**
  \[
  \frac{Sales}{Working\ capital}
  \]
  = Working capital turnover

- Inventory
- Receivable
- Payable
Secondary leverage ratios

\[
\frac{\text{Debt}}{\text{Equity}} \quad \frac{\text{Liabilities}}{\text{Equity}}
\]

Solvency
Secondary leverage ratios

\[
\frac{\text{Debt}}{\text{Equity}} = \text{Debt to equity}
\]

\[
\frac{\text{Liabilities}}{\text{Equity}} = \text{Liabilities to equity}
\]

\[
\frac{\text{Assets}}{\text{Equity}}
\]

If a company is 100% equity funded, this ratio should equal one.
Pyramid of ratios

The primary ratios make up the second tier of the pyramid. This is where the three levers of ROE are situated.

Secondary ratios are on the third tier of the pyramid. The ratios give a quick indication of profitability, efficiency and solvency.

Tertiary ratios make up the fourth tier of the pyramid, and give us further detail and breakdown of individual components.
### Primary ratios

#### Return on Equity
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE</td>
<td>18.74%</td>
<td>25.43%</td>
<td>32.89%</td>
<td>32.22%</td>
<td>32.32%</td>
</tr>
</tbody>
</table>

#### Net Profit Margin
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>NP</td>
<td>18.14%</td>
<td>20.80%</td>
<td>21.53%</td>
<td>17.10%</td>
<td>16.43%</td>
</tr>
</tbody>
</table>

#### Total Assets to Equity
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>TAE</td>
<td>1.16</td>
<td>1.24</td>
<td>1.40</td>
<td>1.36</td>
<td>1.34</td>
</tr>
</tbody>
</table>

#### Asset Turnover
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT</td>
<td>0.89</td>
<td>0.95</td>
<td>1.09</td>
<td>1.37</td>
<td>1.47</td>
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</tbody>
</table>

#### Capital Structure Impact
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
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<th>2009</th>
<th>2010</th>
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<tbody>
<tr>
<td>CS</td>
<td>1.16</td>
<td>1.06</td>
<td>1.05</td>
<td>1.03</td>
<td>1.01</td>
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</table>

#### EBIT Margin
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBIT</td>
<td>29.13%</td>
<td>26.58%</td>
<td>28.82%</td>
<td>24.61%</td>
<td>21.65%</td>
</tr>
</tbody>
</table>

#### Gross Margin
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>GM</td>
<td>55.20%</td>
<td>54.58%</td>
<td>51.26%</td>
<td>46.07%</td>
<td>44.03%</td>
</tr>
</tbody>
</table>

#### SG&A
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>SG&amp;A</td>
<td>24.96%</td>
<td>17.70%</td>
<td>14.66%</td>
<td>13.51%</td>
<td>13.85%</td>
</tr>
</tbody>
</table>

#### Payable Turnover
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>PT</td>
<td>9.75</td>
<td>10.59</td>
<td>18.80</td>
<td>13.31</td>
<td>13.59</td>
</tr>
</tbody>
</table>

#### Receivable Turnover
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>RT</td>
<td>5.95</td>
<td>4.96</td>
<td>4.81</td>
<td>4.87</td>
<td>5.34</td>
</tr>
</tbody>
</table>

#### R&D
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>R&amp;D</td>
<td>7.69%</td>
<td>7.78%</td>
<td>5.99%</td>
<td>6.19%</td>
<td>6.45%</td>
</tr>
</tbody>
</table>

#### Inventory Turnover
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT</td>
<td>6.88</td>
<td>5.39</td>
<td>7.39</td>
<td>8.75</td>
<td>13.46</td>
</tr>
</tbody>
</table>

#### Working Capital Turnover
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>WCT</td>
<td>5.34</td>
<td>4.11</td>
<td>4.37</td>
<td>4.42</td>
<td>5.33</td>
</tr>
</tbody>
</table>

#### Solvency Ratios
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>TLE</td>
<td>0.16</td>
<td>0.24</td>
<td>0.40</td>
<td>0.38</td>
<td>0.34</td>
</tr>
<tr>
<td>DE</td>
<td>0.01</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
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</table>

#### Liquidity Ratios
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td>4.51</td>
<td>3.51</td>
<td>2.36</td>
<td>2.29</td>
<td>2.29</td>
</tr>
<tr>
<td>Quick Ratio</td>
<td>4.83</td>
<td>3.54</td>
<td>2.69</td>
<td>1.87</td>
<td>2.12</td>
</tr>
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#### Cash Turnover
<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>CT</td>
<td>4.50</td>
<td>4.49</td>
<td>5.07</td>
<td>13.24</td>
<td>9.64</td>
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</table>
### Secondary Ratios

#### Return on Equity

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>18.74%</td>
<td>25.43%</td>
<td>32.89%</td>
<td>32.22%</td>
<td>32.32%</td>
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</table>

#### Net Profit Margin

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>18.14%</td>
<td>20.80%</td>
<td>21.53%</td>
<td>17.10%</td>
<td>16.43%</td>
</tr>
</tbody>
</table>

#### Total Assets to Equity

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>1.16</td>
<td>1.24</td>
<td>1.40</td>
<td>1.36</td>
<td>1.34</td>
</tr>
</tbody>
</table>

#### Asset Turnover

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>0.89</td>
<td>0.95</td>
<td>1.09</td>
<td>1.37</td>
<td>1.47</td>
</tr>
</tbody>
</table>

#### Capital Structure Impact

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>1.16</td>
<td>1.06</td>
<td>1.05</td>
<td>1.03</td>
<td>1.01</td>
</tr>
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</table>

#### Tax Ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>77.81%</td>
<td>73.53%</td>
<td>71.40%</td>
<td>67.58%</td>
<td>75.22%</td>
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</table>

#### PPE/Capital asset Turnover

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>6.33</td>
<td>6.23</td>
<td>8.51</td>
<td>8.29</td>
<td>7.64</td>
</tr>
</tbody>
</table>

#### Working Capital Turnover

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>5.34</td>
<td>4.11</td>
<td>4.37</td>
<td>4.42</td>
<td>5.33</td>
</tr>
</tbody>
</table>

#### EBIT Margin

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>29.13%</td>
<td>26.58%</td>
<td>28.82%</td>
<td>24.61%</td>
<td>21.65%</td>
</tr>
</tbody>
</table>

#### Gross Margin

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>55.20%</td>
<td>54.58%</td>
<td>51.26%</td>
<td>46.07%</td>
<td>44.03%</td>
</tr>
</tbody>
</table>

#### SG&A

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>24.96%</td>
<td>17.70%</td>
<td>14.66%</td>
<td>13.51%</td>
<td>13.85%</td>
</tr>
</tbody>
</table>

#### Payable Turnover

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>9.75</td>
<td>10.59</td>
<td>18.80</td>
<td>13.31</td>
<td>13.59</td>
</tr>
</tbody>
</table>

#### Receivable Turnover

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>5.95</td>
<td>4.96</td>
<td>4.81</td>
<td>4.87</td>
<td>5.34</td>
</tr>
</tbody>
</table>

#### Inventory Turnover

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>6.88</td>
<td>5.39</td>
<td>7.39</td>
<td>8.75</td>
<td>13.46</td>
</tr>
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#### R&D

<table>
<thead>
<tr>
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<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>7.69%</td>
<td>7.78%</td>
<td>5.99%</td>
<td>6.19%</td>
<td>6.45%</td>
</tr>
</tbody>
</table>

#### Receivable Turnover

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>7.69%</td>
<td>7.78%</td>
<td>5.99%</td>
<td>6.19%</td>
<td>6.45%</td>
</tr>
</tbody>
</table>

#### Cash Turnover

<table>
<thead>
<tr>
<th>Year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>4.50</td>
<td>4.49</td>
<td>5.07</td>
<td>13.24</td>
<td>9.64</td>
</tr>
</tbody>
</table>

#### Solvency Ratios

<table>
<thead>
<tr>
<th>Ratio</th>
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<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tbody>
<tr>
<td>Total Liabilities to Equity</td>
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<td>0.24</td>
<td>0.40</td>
<td>0.38</td>
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<tr>
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<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
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#### Liquidity Ratios

<table>
<thead>
<tr>
<th>Ratio</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td>4.51</td>
<td>3.51</td>
<td>2.36</td>
<td>2.29</td>
<td>2.29</td>
</tr>
<tr>
<td>Quick Ratio</td>
<td>4.83</td>
<td>3.54</td>
<td>2.69</td>
<td>1.87</td>
<td>2.12</td>
</tr>
</tbody>
</table>
## Tertiary ratios

<table>
<thead>
<tr>
<th>Net Profit Margin</th>
<th>Return on Equity</th>
<th>Total Assets to Equity</th>
<th>Asset Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006: 18.14%</td>
<td>2006: 18,74%</td>
<td>2006: 1.16</td>
<td>2006: 0.89</td>
</tr>
<tr>
<td>2007: 20.80%</td>
<td>2007: 25.43%</td>
<td>2007: 1.24</td>
<td>2007: 0.95</td>
</tr>
<tr>
<td>2010: 16.43%</td>
<td>2010: 32.32%</td>
<td>2010: 1.34</td>
<td>2010: 1.47</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital Structure Impact</th>
<th>Tax Ratio</th>
<th>PPE/Capital asset Turnover</th>
<th>Working Capital Turnover</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Gross Margin</th>
<th>EBIT Margin</th>
<th>SG&amp;A</th>
<th>Payable Turnover</th>
<th>Inventory Turnover</th>
<th>Receivable Turnover</th>
<th>Cash Turnover</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Dep. &amp; Amart.</th>
<th>R&amp;D</th>
<th>Solvency Ratios</th>
<th>Liquidity Ratios</th>
<th>Tertiary ratios</th>
</tr>
</thead>
</table>

### Key Ratios
- **Return on Equity (ROE)**: Measures the profitability of a company's equity. Higher values indicate more profitability from the company's equity.
- **Net Profit Margin**: Measures the profitability of sales. It shows how much of every dollar of sales is converted to profit.
- **Total Assets to Equity**: Indicates the proportion of total assets financed by equity. A higher ratio suggests less reliance on debt.
- **Asset Turnover**: Measures how efficiently a company uses its assets to generate revenue. A higher ratio suggests better asset management.
- **Capital Structure Impact**: Measures the impact of capital structure on financial ratios. It helps in understanding the debt to equity ratio's effect on other financial ratios.
- **Tax Ratio**: Measures the tax burden of a company. It is calculated as (Income before tax / Income after tax).
- **PPE/Capital asset Turnover**: Measures the efficiency of property, plant, and equipment. A higher ratio suggests better asset use.
- **Working Capital Turnover**: Measures how efficiently a company manages its working capital. A higher ratio suggests better cash conversion cycle.
- **EBIT Margin**: Measures the profitability of earnings before interest and taxes. Higher values indicate higher profitability.
- **Gross Margin**: Measures the profitability of sales excluding operating expenses. A higher ratio indicates a higher margin on sales.
- **SG&A**: Measures the sales, general, and administrative expenses as a percentage of sales. Lower values indicate more efficient management of these expenses.
- **Payable Turnover**: Measures how efficiently a company pays its accounts payable. A higher ratio suggests better management of cash outflows.
- **Inventory Turnover**: Measures how efficiently a company manages its inventory. A higher ratio suggests better inventory management.
- **Dep. & Amart.**: Measures the depreciation and amortization expenses as a percentage of sales. Lower values indicate more efficient management of these expenses.
- **R&D**: Measures the research and development expenses as a percentage of sales. Higher values indicate a focus on innovation and development.
- **Receivable Turnover**: Measures how efficiently a company collects its receivables. A higher ratio suggests better cash conversion cycle.
- **Cash Turnover**: Measures how efficiently a company converts its cash into sales. A higher ratio suggests better cash management.
## Final ratios

<table>
<thead>
<tr>
<th>Ratio Type</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Return on Equity</strong></td>
<td>18.74%</td>
<td>25.43%</td>
<td>32.89%</td>
<td>32.22%</td>
<td>32.32%</td>
</tr>
<tr>
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<td>17.10%</td>
<td>16.43%</td>
</tr>
<tr>
<td><strong>Total Assets to Equity</strong></td>
<td>1.16</td>
<td>1.24</td>
<td>1.40</td>
<td>1.36</td>
<td>1.34</td>
</tr>
<tr>
<td><strong>Asset Turnover</strong></td>
<td>0.89</td>
<td>0.95</td>
<td>1.09</td>
<td>1.37</td>
<td>1.47</td>
</tr>
<tr>
<td><strong>Capital Structure Impact</strong></td>
<td>1.16</td>
<td>1.06</td>
<td>1.05</td>
<td>1.03</td>
<td>1.01</td>
</tr>
<tr>
<td><strong>Tax Ratio</strong></td>
<td>77.81%</td>
<td>73.53%</td>
<td>71.40%</td>
<td>67.58%</td>
<td>75.22%</td>
</tr>
<tr>
<td><strong>PPE/Capital asset Turnover</strong></td>
<td>6.33</td>
<td>6.23</td>
<td>8.51</td>
<td>8.29</td>
<td>7.64</td>
</tr>
<tr>
<td><strong>Working Capital Turnover</strong></td>
<td>5.34</td>
<td>4.11</td>
<td>4.37</td>
<td>4.42</td>
<td>5.33</td>
</tr>
<tr>
<td><strong>EBIT Margin</strong></td>
<td>29.13%</td>
<td>26.58%</td>
<td>28.82%</td>
<td>24.61%</td>
<td>21.65%</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>55.20%</td>
<td>54.58%</td>
<td>51.26%</td>
<td>46.07%</td>
<td>44.03%</td>
</tr>
<tr>
<td><strong>SG&amp;A</strong></td>
<td>24.96%</td>
<td>17.70%</td>
<td>14.66%</td>
<td>13.51%</td>
<td>13.85%</td>
</tr>
<tr>
<td><strong>Payable Turnover</strong></td>
<td>9.75</td>
<td>10.59</td>
<td>18.80</td>
<td>13.31</td>
<td>13.59</td>
</tr>
<tr>
<td><strong>Inventory Turnover</strong></td>
<td>6.88</td>
<td>5.39</td>
<td>7.39</td>
<td>8.75</td>
<td>13.46</td>
</tr>
<tr>
<td><strong>Dep. &amp; Amort.</strong></td>
<td>2.42%</td>
<td>2.53%</td>
<td>1.80%</td>
<td>1.76%</td>
<td>2.08%</td>
</tr>
<tr>
<td><strong>R&amp;D</strong></td>
<td>7.69%</td>
<td>7.78%</td>
<td>5.99%</td>
<td>6.19%</td>
<td>6.45%</td>
</tr>
<tr>
<td>** Receivable Turnover**</td>
<td>5.95</td>
<td>4.96</td>
<td>4.81</td>
<td>4.87</td>
<td>5.34</td>
</tr>
<tr>
<td><strong>Solvency Ratios</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities to Equity</strong></td>
<td>0.16</td>
<td>0.24</td>
<td>0.40</td>
<td>0.38</td>
<td>0.34</td>
</tr>
<tr>
<td><strong>Debt to Equity</strong></td>
<td>0.01</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
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<td><strong>Liquidity Ratios</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td><strong>Current Ratio</strong></td>
<td>4.51</td>
<td>3.51</td>
<td>2.36</td>
<td>2.29</td>
<td>2.29</td>
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<tr>
<td><strong>Quick Ratio</strong></td>
<td>4.83</td>
<td>3.54</td>
<td>2.69</td>
<td>1.87</td>
<td>2.12</td>
</tr>
<tr>
<td><strong>Cash Turnover</strong></td>
<td>4.50</td>
<td>4.49</td>
<td>5.07</td>
<td>13.24</td>
<td>9.64</td>
</tr>
</tbody>
</table>
Conclusion

Module 1
Analyzing the income statement

Module 2
Analyzing the balance sheet

Module 3
Funding the business

Module 4
Pyramid of ratios
FMVA™ Certification