

## **Guidelines for Interpretation of Ratios**

The following guidelines will help to understand what interpretation means and how it should be done.

### **What does interpretation of ratios mean?**

Interpretation means explanation of the ratios results. It does not mean definition of ratios rather it should enable the readers to understand what the calculated ratio indicates and what the trend for that particular ratio is. It should cover three steps:

**Step # 1) Result understanding:** i.e. what does the answer derived from ratio calculation indicates? You have to critically analyze the result of calculated ratio by explaining the relationship of numerator with that of a denominator.

**Step #2) Trend Analysis:** i.e. what are the variations in a company's ratio results i.e. the trend for the same company and the reasons for that change in trend?

**Step #3) Bench mark (if applicable):** i.e. the comparison of ratio with the benchmark/rule of thumb/standard of that ratio in that particular industry (as these standards vary according to the type of industry selected for analysis e.g. Manufacturing, Banking, FMCG companies, etc). Also give reasoning of deviation from that standard.

**You will have to interpret the calculated ratios in the way described above step wise.**