

Essentials for Ratio Analysis

Ratio analysis is the calculation and comparison of ratios which are derived from the information in a company's financial statements. Financial ratios are usually expressed in percentages or times or rupees.

Ratios Required for Banks/DFIs

- 1) Net Profit Margin
- 2) Gross Spread Ratio
- 3) Spread Ratio
- 4) Non Interest Income to Total Income Ratio
- 5) Return on Assets (ROA)
- 6) Du Pont Return on Assets Ratio
- 7) Return on Equity (ROE)
- 8) Debt Ratio
- 9) Debt / Equity Ratio
- 10) Times Interest Earned Ratio
- 11) Advances / Deposits Ratio
- 12) Operating Cash Flow Ratio
- 13) Dividend per Share
- 14) Earning per Share
- 15) Price/Earning Ratio

Ratios Required for Other Companies

- 1) Current Ratio
- 2) Acid Test Ratio
- 3) Working Capital
- 4) Times Interest Earned
- 5) Debt Ratio
- 6) Debt / Equity Ratio
- 7) Net Profit Margin
- 8) Gross Profit Margin
- 9) Return on Assets(ROA)
- 10) Operating Income Margin
- 11) Return on Equity
- 12) Assets Turnover Ratio
- 13) Operating Cash Flow Ratio
- 14) Dividend per Share
- 15) Earning per Share

Ratios Required for Insurance Companies

- 1) Debt Ratio
- 2) Debt / Equity Ratio
- 3) Return on Assets(ROA)
- 4) Return on Equity
- 5) Operating Cash Flow Ratio
- 6) Dividend per Share
- 7) Earning per Share
- 8) Net Claims to Net Premiums Ratio
- 9) Expenditures (Management expenses) to Total Net Income Ratio
- 10) Net premiums to Gross Premiums Ratio
- 11) Underwriting expenses to Net Premiums Ratio
- 12) Outstanding Claims to Net Claims Ratio
- 13) Net Investment Income to Total Investments Ratio
- 14) Growth in Net Premiums Ratio
- 15) Net premiums to Total Income/Revenue Ratio

Presentation of Ratio Analysis

Ratio analysis is a very important part of your internship report and should be presented properly.

Five Steps for Presenting Ratio Analysis

For the presentation of ratio analysis students are required to follow these five steps described below for each ratio.

Step 1-Ratio Title and Formula

Write the ratio title (definition and description is not required) and formula.

For example:

Current ratio = Current assets/current liabilities

Step 2-Calculation (with numerator and denominator) Show

the table as given below:

| Year 20X1 | Year 20X2 | Year 20X3 |
|--|-----------|-----------|
| Show the amounts in numerator and denominator and then the final result. i.e. $= \frac{XXX}{YYY}$ $= ZZ \text{ Times}$ | | |
| <ul style="list-style-type: none"> ◆ Mention the unit of the respective ratio with its result such as current ratio is calculated in “Times” so write “Times” with current ratio’s result. ◆ Also round off the result up to two decimal places. E.g. if answer is 2.4659 times then it should be written as 2.46 times. ◆ Years should be presented in ascending order from left to right. | | |

Step 3-Working

After the calculation table show how you have calculated the amounts given in numerator and denominator (for those items that require calculations).

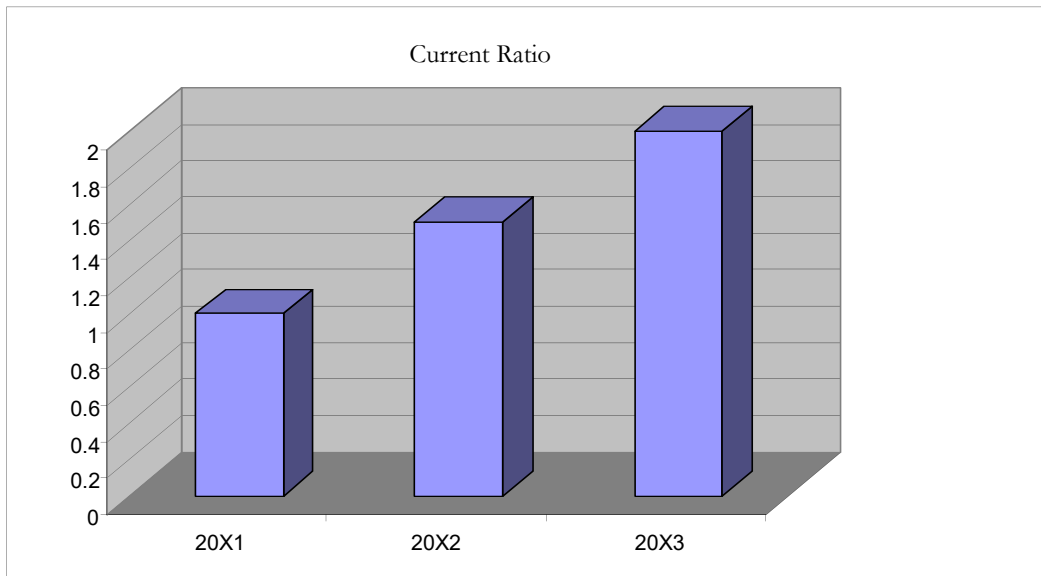
NOTE:

If any amount is clearly provided in the financial statements then there is no need to show the working for those amounts. For example if total assets amount is provided in the financial statements no working for calculating total assets is required.

Step 4-Graphical representation

Plot the calculated ratio results on graph. Use only **Column chart** for graphical representation.

Show graphical representation like this:



NOTE:

You are not required to show Trend Analysis separately. Instead plot the graphs of each ratio according to the given specimen. In this way while showing the graphs and interpreting the ratios, you will also be performing Trend Analysis.

Step 5-Interpretation

In this section interpret the graph shown above.

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 the following 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. I.e. if the result of current ratio for a

year is 2.1 times then what is meant by this 2.1 times. For supporting your interpretation results you will not use the values provided in the Balance Sheet of the current assets and current liabilities.

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) Comparisons: i.e. the company's performance (better/ poor/ same) for the three consecutive years along with reasons.

Step 4) 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.

NOTE

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

Important Points to be Considered

- You have to follow the same format for all the ratios that you will calculate. Remember, without formulas, working, graphs and interpretations your analysis will **NOT** be accepted.
- You must provide audited scanned copies of all the financial statements used for financial analysis. However, if you have downloaded the financial statements from organization's website then URL or web link should be provided. In this case, scanned copies will not be required. Without providing the scanned copies or URL of the organization's website, your work will **NOT** be accepted /evaluated. Scanned copies should be provided in the following format:

Resolution: 200 dpi

File type: JPEG

Size: 300-400 kb

- It is **COMPULSORY** for the students to calculate the ratios according to their organization's sector only. E.g. a student who has selected a bank is required to calculate the ratios mentioned above (**Ratios Required for Banks/DFIs**) only. Ratios calculated other than those mentioned above will **NOT** be considered. You are required to calculate/analyze **all ratios** mentioned above. Skipping any of ratios mentioned above is **NOT** allowed.
- Ratio analysis should be conducted on audited annual reports of the company which you have selected for your internship report. However, if both consolidated as well as unconsolidated financial statements are available then make sure that you have to conduct ratio analysis on **Unconsolidated/Standalone Financial Statements**.
Note: Students should know the difference between unconsolidated and consolidated financial statements. Consolidated statements comprise the accounts of whole group (more than one business units) of an organization. While, on the other

hand, unconsolidated statements represent the accounts of single business unit (normally a holding company).

- All these ratios have been taught to you under the subject of Financial Management (MGT201), Corporate Finance (Fin622), Financial Statement Analysis (FIN621) and Investment Analysis & Portfolio Management (FIN630). So consult handouts and reference books of these courses to get help about ratios and their formulas.