



Module 7: Ratio Analysis

C-AE24 — Strategic Business Analysis | **Financial Statement Analysis**

BS ACCOUNTANCY · BS ACCOUNTING INFORMATION SYSTEM

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A New Way to See Numbers

Most People See a Wall of Numbers. You'll See a Diagnosis.

Financial statements look complex on the surface — but Ratio Analysis translates them into clear, actionable indicators of a company's true health.

i By the end of Module 7, you'll read any annual report like a strategic consultant — not just a student memorizing formulas.

The Framework

Three Diagnostic Checkpoints

Just as a doctor checks vital signs before drawing conclusions, analysts examine three core dimensions before declaring a company healthy.



Liquidity

Can the company pay its bills
tomorrow?



Profitability

Is the company creating **real value**
from operations?



Solvency

Can the company survive **the next decade?**

PART 1

Liquidity — Can You Pay Your Bills Tomorrow?

Liquidity is the first vital sign. It measures whether a company has sufficient short-term assets to cover its immediate obligations — before long-term strategy even enters the picture.



Liquidity Ratios

The Two Core Liquidity Tools

Current Ratio

$$\text{Current Assets} \div \text{Current Liabilities}$$

Measures broad short-term coverage. A ratio above 1.0 means the company can cover obligations with available assets.

Quick Ratio

$$(\text{Current Assets} - \text{Inventory}) \div \text{Current Liabilities}$$

A stricter test — excludes inventory, which may not convert to cash quickly in a crisis.

The Jollibee Insight

A **higher** liquidity ratio isn't always better. Idle cash earns nothing — it loses value to inflation.

Jollibee intentionally keeps liquidity **lean** to fund aggressive store expansions globally, while maintaining just enough coverage to safely meet short-term obligations.

❏ Strategic analysts ask: *Is liquidity optimized — or merely maximized?*

Liquidity — Can You Pay Your Bills Tomorrow?

Beyond the Basics: Deeper Dives into Liquidity

While the Current and Quick Ratios provide foundational insights, a closer look at specific operational metrics reveals the true fluidity of a company's working capital.



Receivables Turnover

Measures how quickly a company collects its credit sales.



Inventory Turnover

Indicates the efficiency in converting inventory into sales.



Days in Receivables

The average number of days to collect payments from customers.



Days in Inventory

The average number of days inventory is held before being sold.



Free Cash Flow

Cash available after all operating expenses and capital investments.



PART 2

Profitability — Are Operations Creating Real Value?

Survival isn't enough. Once a business clears the liquidity hurdle, the next question is whether it's actually generating returns worth investing in.

Key Profitability Ratios

Measuring Value Creation

Gross Margin

$$\text{(Revenue - COGS)} \div \text{Revenue}$$

Reveals pricing power. If raw material costs rise due to inflation, does the company protect its margins — or does profit evaporate?

Net Profit Margin

$$\text{Net Income} \div \text{Revenue}$$

Bottom-line efficiency after all costs, interest, and taxes. Reflects the company's overall control over expenses.

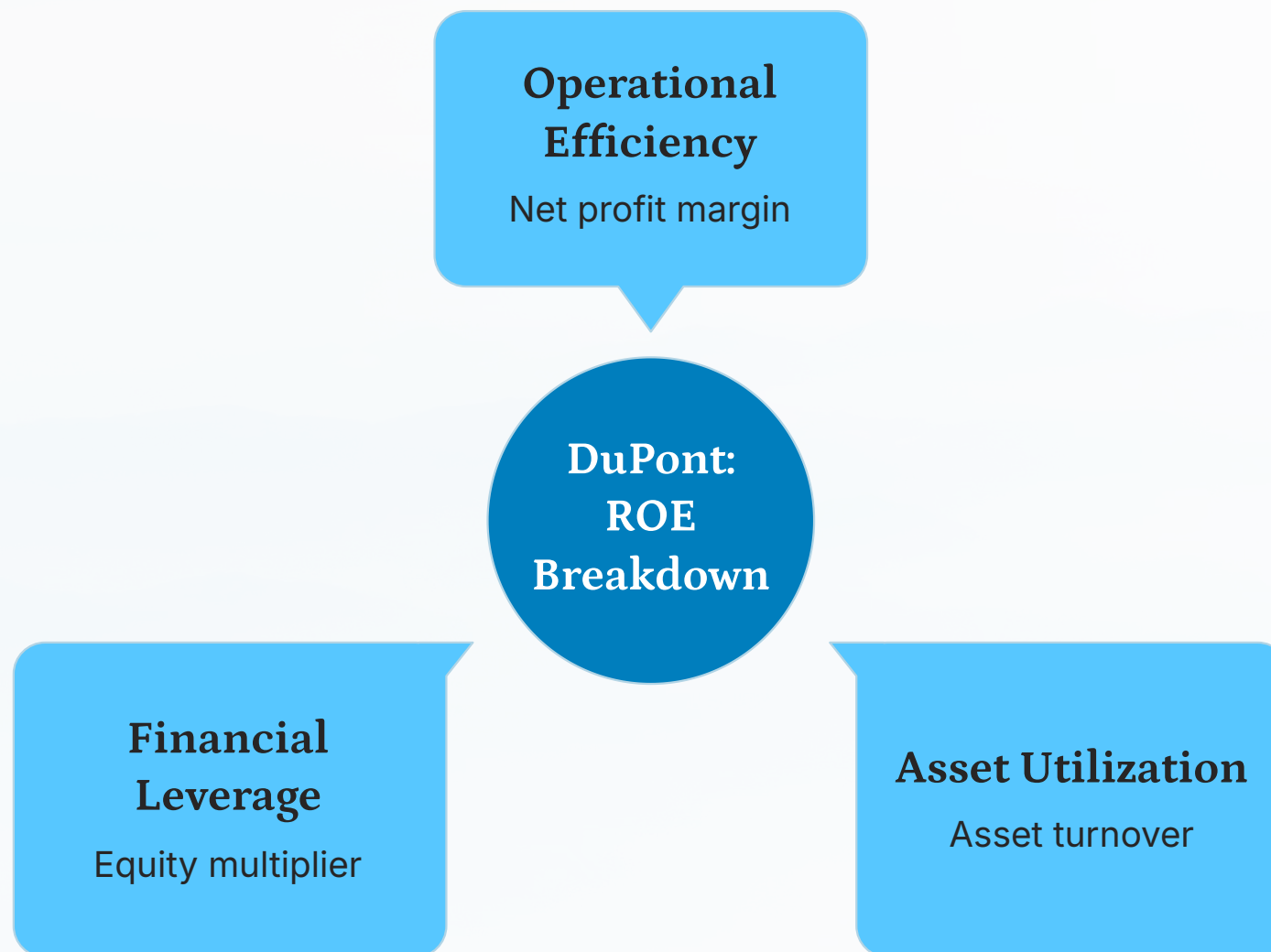
Return on Equity (ROE)

$$\text{Net Income} \div \text{Shareholders' Equity}$$

The metric equity investors watch most closely — how effectively is shareholder capital being turned into profit?

DuPont Analysis — Unpacking ROE

ROE alone doesn't tell the full story. DuPont breaks it into **three distinct levers** so analysts can pinpoint exactly *where* returns are coming from.



This framework separates tight operations from inflated returns driven by heavy borrowing — a critical distinction in strategic analysis.



PART 3

Solvency — The Long Game

If liquidity is about surviving **tomorrow**, solvency is about surviving **the next decade**.

When companies like Jollibee expand internationally — acquiring global coffee chains and restaurant brands — they borrow heavily to fund those deals. Solvency ratios reveal whether that debt is a *growth accelerator* or a *structural risk*.

Solvency Ratios

Assessing Long-Term Financial Stability

Debt-to-Equity Ratio

Total Debt ÷ Shareholders' Equity

Measures how much of the business is financed by debt versus owner capital. A rising ratio signals increasing financial risk, especially in high-interest environments.

Interest Coverage Ratio

EBIT ÷ Interest Expense

Can the company cover its interest payments from operating profit alone? A ratio below 1.5x is a red flag — the business may struggle to service its debt.

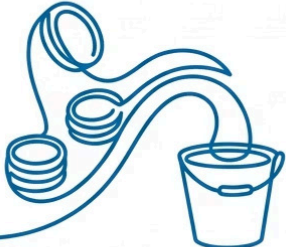
Debt-to-Assets Ratio

Total Debt ÷ Total Assets

Shows what proportion of assets are financed through borrowing. Useful for assessing overall leverage and creditor risk exposure.

Putting It Together

The Full Financial Diagnostic

LIQUIDITY (Short-Term Survival)	PROFITABILITY (Value Creation)	SOLVENCY (Long-Term Stability)
		
		
Current Ratio, Quick Ratio	Gross Margin, Net Margin, ROE, DuPont Analysis	Debt-to-Equity, Interest Coverage, Debt-to-Assets

Ratio Analysis is not a formula exercise — it is a **strategic thinking framework**. Each category answers a fundamentally different question about a company's health.

- **Liquidity** — Immediate survival capacity
- **Profitability** — Quality of earnings and returns
- **Solvency** — Structural resilience over time

✔ Applied together, these three lenses reveal what the headline numbers never show.



You're Ready to Decode Any Annual Report

By the end of Module 7, you won't just pass an exam — you'll open any company's financials and see past the corporate PR to its true financial condition.

01

Open your module materials

Review the ratio formulas, worked examples, and case studies.

02

Apply DuPont to a real company

Practice decomposing ROE using a published annual report.

03

Think like a strategic consultant

What do the ratios reveal that the narrative doesn't?

Good luck this week — see you in the lecture. 📊