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10 Financial Terms of Investing explained ■■

- 1) EBITDA
- 2) PAT
- 3) ROE
- 4) ROCE
- 5) D/E Ratio
- 6) Acid Test Ratio
- 7) Working Capital Turnover
- 8) PE
- 9) PS Ratio
- 10) Interest Coverage

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1) Earnings before Interest Tax Depreciation & Amortization (EBITDA) margin -

It shows how efficiently an organization is operating.

Ratio = EBDITA / Net Sales

EBITDA = Operating Income (EBIT) + Depreciation + Amortization

EBDITA Margin of 10% and more is considered good.

2) PAT Margin -

Its similar to EBDITA Margin, the only difference is - it is calculated after taxes.

PAT Margin = [PAT/Total Revenues]

A good margin will vary considerably by industry, but as a general rule of thumb, 5% is low, 10% is avg and 20% can be considered high

3) Return on equity

It indicates how much return the shareholders are making over their initial investment in the company

ROE - $[\text{Net Profit} / \text{Shareholders Equity} * 100]$

Generally 15%+ ROE can be considered to invest in a company with a good cashflow and low debt.

4) ROCE - Return on Capital Employed

Return on Capital employed indicates the overall return the company generates considering both the equity and debt

ROCE = $[\text{Profit before Interest \& Taxes} / \text{Overall Capital Employed}]$

ROCE of 15% and above is considered good

5) Debt to Equity Ratio -

It can be measured directly from Balance sheet - $[\text{Total Debt} / \text{Total Equity}]$

D/E Ratio < 1 = Safe

1 < D/E < 2 = Moderate

D/E > 2 Aggressive and risky

Lower is better, means funds can be arranged easily

But then again depends on Sector to Sector

6) Interest coverage Ratio -

The interest coverage ratio is a debt and profitability ratio used to determine how easily a company can pay interest on its outstanding debt.

IC Ratio - $[\text{Earnings before Interest and Tax} / \text{Interest Payment}]$

Higher is better

7) Acid Test Ratio -

The acid-test ratio is a measure of how well a company can satisfy its short-term (current) financial obligations.

Ratio - $\{\text{Currents Assets} - \text{Inventories}\} / \text{Current Liabilities}$

Ideally, a business should have an acid-test ratio of at least 1:1

8) Working Capital Turnover -

Working capital turnover ratio indicates how much revenue the company generates for every unit of working capital.

Working Capital Turnover = $[\text{Revenue} / \text{Average Working Capital}]$

Higher the working capital turnover ratio the better it is

9) P/S - Price/Sales Ratio

This ratio compares the stock price of the company with the company's sales per share

Price to sales ratio = $\text{Current Share Price} / \text{Sales per Share}$

One can easily find overvalued and undervalued stocks using this ratio and by comparison with peers

10) Price to Earning (P/E) Ratio

$P/E = \text{Stock Price} / \text{Earning per Share}$

P/E indicates how expensive or cheap the stock is trading at - lower is better

Compare PE of similarly placed companies to find undervalued gems.

Follow our handle @myfirststock99 as we keep posting such stuff every weekend.

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