1FP571
Special seminar – Advanced Corporate Finance

EVROPSKÁ UNIE
Evropské strukturální a investiční fondy
Operační program Výzkum, vývoj a vzdělávání

MINISTERSTVO ŠKOLSTVÍ, MLÁDEŽE A TĚLOVÝCHOVY

Short-Term Liquidity

Looks at the firm’s ability to pay for obligations due during its operating cycle (wages, purchases of inventory)

Current Ratio, Quick Ratio, Inventory Turnover, …

Short-Term Liquidity
Current Ratio

Current Ratio = Current Assets / Current Liabilities

Matches the amount of cash and other current assets that will become cash within one year against the obligations that come in the next year. Basic rule of thumb: minimum 1.0

Conservative: Current Ratio > 2.5

Average: Current Ratio ϵ <1.5;2.5>

Aggressive: Current ratio < 1.5

Short-Term Liquidity
Quick Ratio (Acid Test)

Quick Ratio (Acid Test) = (Current Assets – Inventory) / Current Liabilities

Quick Assets = Current Assets – Inventory = Cash + Marketable Securities + Accounts Receivable. Includes in the numerator only those current assets that the firm may convert quickly into cash

Conservative strategy: Quick Ratio > 1.5

Average: Current Ratio ϵ <1.0;1.5>

Aggressive: Current ratio < 1.0

Short-Term Liquidity
Cash Ratio

Cash Ratio = Cash / Current Liabilities

Coverage of current liabilities by the most liquid assets available to the firm (cash)

Short-Term Liquidity
Operating CF to CL Ratio

Operating Cash Flow to Current Liabilities Ratio = Operating Cash Flow / Average Current Liabilities

Another measure of a company short-term liquidity

Its advantage: based on a cash flow AFTER all the funding needs required by the working capital were met (i.e. accounts receivable and inventory)

Short-Term Liquidity
Accounts Receivable

Accounts Receivable Turnover	=	Sales / Average Accounts Receivable
Days Receivable Outstanding	=	365 / Invenory Turnover

Short-Term Liquidity
Accounts Payable

Accounts Payable Turnover	=	Purchases / Average Accounts Payable
Days Payable Outstanding	=	365 / Accounts Payable Turnover

Short-Term Liquidity
Inventory

Inventory Turnover = Cost of Goods Sold / Avg Inventories

Days Inventory Outstanding = 365 / Inventory Turnover

Short-Term Liquidity
OpCF to Cash Int. Costs Ratio

Operating Cash Flow to Cash Interest Costs Ratio	=	(Cash Flows from Operation + Cash Outflow For Interest + Cash Outflow for Income Taxes) / Cash Outflow for Interest

Short-Term Liquidity
OpCF to Cash Int. Costs Ratio

REFERENCE

Wysocki, Peter. Business Analysis Using Financial Statements, Course Number 15.535, Sloan School of Management. Lecture Notes Class 12, MIT OpenCourseWare, https://ocw.mit.edu/courses/15-535-business-analysis-using-financial-statements-spring-2003/resources/class12/

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