



1FP571

Special seminar – Advanced Corporate Finance



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



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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

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

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 $\in <1.5; 2.5>$

Aggressive: Current ratio < 1.5



Short-Term Liquidity

Quick Ratio (Acid Test)

$$\begin{array}{lcl} \text{Quick Ratio} & & (\text{Current Assets} - \text{Inventory}) / \\ \text{(Acid Test)} & = & \text{Current Liabilities} \end{array}$$

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 \in <1.0;1.5>

Aggressive: Current ratio < 1.0

Short-Term Liquidity

Cash Ratio

$$\text{Cash Ratio} = \text{Cash} / \text{Current Liabilities}$$

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



Short-Term Liquidity

Operating CF to CL Ratio

$$\begin{array}{l} \text{Operating Cash Flow to} \\ \text{Current Liabilities Ratio} \\ \text{Liabilities} \end{array} = \begin{array}{l} \text{Operating Cash Flow /} \\ \text{Average Current} \end{array}$$

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 = $\frac{\text{Sales}}{\text{Average Accounts Receivable}}$

Days Receivable
Outstanding = $\frac{365}{\text{Inventory Turnover}}$



Short-Term Liquidity

Accounts Payable

Accounts Payable
Turnover = $\frac{\text{Purchases}}{\text{Average Accounts Payable}}$

Days Payable
Outstanding = $\frac{365}{\text{Accounts Payable Turnover}}$

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

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