## What Is Ratio Analysis?

Ratio analysis is a quantitative method of gaining insight into a company's liquidity, operational efficiency, and profitability by studying its financial statements such as the balance sheet and income statement. Ratio analysis is a cornerstone of [fundamental equity analysis](https://www.investopedia.com/terms/f/fundamentalanalysis.asp).

## What Does Ratio Analysis Tell You?

Investors and analysts employ ratio analysis to evaluate the financial health of companies by scrutinizing past and current financial statements. Comparative data can demonstrate how a company is performing over time and can be used to estimate likely future performance. This data can also compare a company's financial standing with industry averages while measuring how a company stacks up against others within the same sector.

Investors can use ratio analysis easily, and every figure needed to calculate the ratios is found on a company's financial statements.

Types of Ratio Analysis

### 1.Liquidity Ratios

[**Liquidity ratios**](https://www.investopedia.com/terms/l/liquidityratios.asp) measure a company's ability to pay off its short-term debts as they become due, using the company's current or quick assets. Liquidity ratios include the current ratio, quick ratio, and working capital ratio.

### 2. Solvency Ratios

Also called financial leverage ratios, [**solvency ratios**](https://www.investopedia.com/terms/s/solvencyratio.asp) compare a company's debt levels with its assets, equity, and earnings, to evaluate the likelihood of a company staying afloat over the long haul, by paying off its long-term debt as well as the interest on its debt. Examples of solvency ratios include: debt-equity ratios, debt-assets ratios, and interest coverage ratios.

### 3. Profitability Ratios

These ratios convey how well a company can generate profits from its operations. Profit margin, return on assets, return on equity, return on capital employed, and gross margin ratios are all examples of[profitability ratios](https://www.investopedia.com/terms/p/profitabilityratios.asp).

### 4. Efficiency Ratios

Also called activity ratios, [**efficiency ratios**](https://www.investopedia.com/terms/e/efficiencyratio.asp) evaluate how efficiently a company uses its assets and liabilities to generate sales and maximize profits. Key efficiency ratios include: turnover ratio, inventory turnover, and days' sales in inventory.

### 5. Coverage Ratios

[**Coverage ratios**](https://www.investopedia.com/terms/c/coverageratio.asp)measure a company's ability to make the interest payments and other obligations associated with its debts. Examples include the [times interest earned ratio](https://www.investopedia.com/terms/t/tie.asp) and the [debt-service coverage ratio.](https://www.investopedia.com/terms/d/dscr.asp)

### 6. Market Prospect Ratios

These are the most commonly used ratios in fundamental analysis. They include [dividend yield](https://www.investopedia.com/terms/d/dividendyield.asp), [P/E ratio](https://www.investopedia.com/terms/p/price-earningsratio.asp), earnings per share ([EPS](https://www.investopedia.com/terms/e/eps.asp)), and [dividend payout ratio](https://www.investopedia.com/terms/d/dividendpayoutratio.asp). Investors use these metrics to predict earnings and future performance.