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# Foundations of Commercial Lines

Understanding Insurance Industry Financial Measures  
Part 2 - Financial Ratios



# Financial ratio analysis

## What is a ratio?

- A comparison of variables from financial statements
- Ratio calculations allow us to see relationships between one variable and another
- This can tell us a lot about the way an organization is handling their finances



# Financial ratio analysis

## Benchmarks

Used to assess business profitability and performance through comparison by:

- **Time trend analysis** - this allows us to see how the ratios change over time
- **Peer group analysis** - this allows us to compare a company with other similar types of companies (peer companies)



# Financial ratio analysis

There are 5 major types of ratios:

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## **Liquidity ratios** (aka short-term solvency ratios)

- Show if the company can pay their bills in the short run

## **Leverage ratios** (aka long-term solvency ratios)

- Show the company's ability to pay their debts

## **Market value ratios**

- Compare variables in the financial statements with market value information, like stock price

## **Asset management ratios**

- Show how efficiently an organization uses their assets to generate sales

## **Profitability measures**

- Show how efficiently the firm manages their operations.  
The focus here is on the bottom line - net income

# Liquidity ratios

**Current ratio =**

Current assets

Current liabilities

**Quick ratio =**

(current assets - inventory)

Current liabilities

*\*This document is for educational purposes only. The data shown is illustrative and does not represent the latest information from Everest.*

## XYZ Corporation

September 2022

### Balance Sheet

#### Assets

Cash & Short-Term Investments	8,938
Short-Term Receivables	1,649
Inventories	1,401
Other Current Assets	507
Total Current Assets	12,494

Net Property, Plant & Equipment	5,929
Total Investments and Advances	602
Intangible Assets	4,584
Deferred Tax Assets	135
Other Assets	412
Total Assets	24,156

#### Liabilities & Shareholders' Equity

ST Debt & Curr. Portion LT Debt	354
Accounts Payable	1,179
Income Tax Payable	287
Other Current Liabilities	3,864
Total Current Liabilities	5,684

Long-Term Debt	9,144
Provision for Risks & Charges	82
Deferred Tax Liabilities	495
Other Liabilities	7,575
Total Liabilities	22,981

Common Equity	1,170
Total Shareholders' Equity	1,170
Accumulated Minority Interest	6
Total Equity	1,176
Total Liabilities & Shareholders' Equity	24,156

# Leverage ratios

$$\text{Total debt ratio} = \frac{\text{Total assets} - \text{total equity}}{\text{Total assets}}$$

$$\text{Debt to equity ratio} = \frac{\text{Total debt}}{\text{Total equity}}$$

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# Market value ratios

**Earnings per share =**

Net income

Shares outstanding

**Price to earnings ratio =**

Price per share

Earnings per share

**Market to book ratio =**

Market value per share

Book value per share

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# Asset management ratios

**Inventory turnover** =  
Cost of goods sold (COGS)  
 Inventory

**Total asset turnover** =  
Sales  
 Total assets

XYZ Corporation	
September 2022	
Income Statement	
Sales	24,720
Cost of Goods Sold (COGS)	19,105
<b>Gross Income</b>	<b>5,615</b>
SG&A Expense	1,755
<b>EBIT (Operating Income)</b>	<b>3,860</b>
Nonoperating Income - Net	1,026
Interest Expense	175
Unusual Expense - Net	-1,070
Income Taxes	1,262
<b>Net Income</b>	<b>4,518</b>

## XYZ Corporation

September 2022

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# Profitability measures

**Profit margin =**

$\frac{\text{Net income}}{\text{Revenue}}$

**Return on assets =**

$\frac{\text{Net income}}{\text{Total assets}}$

**Return on equity =**

$\frac{\text{Net income}}{\text{Total equity}}$

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September 2022

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Thank you for completing this module.

For more, please complete part 3 and part 4 of  
[Foundations of Commercial Lines:](#)  
[Understanding Insurance Industry Financial Metrics.](#)