

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:

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

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

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

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
Gross Income	5,615
SG&A Expense	1,755
EBIT (Operating Income)	3,860
Nonoperating Income - Net	1,026
Interest Expense	175
Unusual Expense - Net	-1,070
Income Taxes	1,262
Net Income	4,518

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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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.](#)