DEMYSTIFYING
THE DEBT-TO-EQUITY RATIO

THE DEBT-TO-EQUITY RATIO (or D/E Ratio) is a key financial metric that's often used by lenders and other financial services providers to assess the financial health and stability of a potential borrower. Understanding what this ratio is, what if reveals, and why it's important can help you better monitor, manage and maintain the right ratio for your company's current and long-term financial well-being.

SIMPLY PUT...

THE DEBT-TO-EQUITY RATIO IS A FINANCIAL METRIC THAT SHOWS HOW MUCH DEBT A COMPANY IS USING TO RUN ITS BUSINESS.

DO THE MATH

The D/E ratio is calculated by dividing a company's total debt by its total shareholders' equity. (Shareholder's equity is found by subtracting your company's total liabilities from total assets).

$$\text{D/E RATIO} = \frac{\text{TOTAL LIABILITIES} \; \text{(LT debt + ST debt + other fixed payments)}}{\text{SHAREHOLDER'S EQUITY}}$$

BY THE NUMBERS

ABC Corp has total debt of $2 million and total shareholder's equity of $5 million.

Its D/E Ratio = $\frac{\$2{,}000{,}000}{\$5{,}000{,}000}$ = .4 or 40%

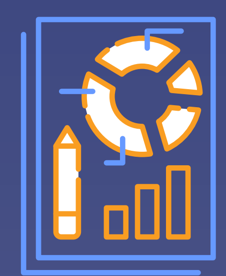
In this example, ABC Corp has a D/E Ratio of 0.4, indicating that 40% of its financing comes from debt. This suggests a relatively lower financial risk compared to a company with a higher ratio.

WHAT'S A HEALTHY RATIO?

The ideal D/E Ratio can vary by industry and a company's stage of development. In general, a ratio below 1 is considered healthy because it indicates that a company has more equity than debt. However, industries with significant capital expenditures (such as utilities or manufacturing) might have higher acceptable ratios.

WHY IT MATTERS

The D/E Ratio is important for several reasons:



ASSESSING FINANCIAL RISK:

A higher ratio indicates a higher level of debt, which may signal to lenders that a company has increased financial risk.

MEASURING FINANCIAL HEALTH:

A lower D/E ratio usually indicates stronger financial health and stability, whereas a higher ratio may indicate that a company is overleveraged and could have trouble repaying debt during economic downturns or other challenges.

CULTIVATING INVESTOR CONFIDENCE:

Investors and creditors use this ratio to evaluate a company's ability to meet its long-term obligations. A lower ratio may instill more confidence in investors.

THE BOTTOM LINE

The Debt-to-Equity Ratio is a crucial financial metric when it comes to determining a company's financial structure and risk. It provides valuable insights for investors, creditors, and leadership so you can make more informed decisions that strengthen the financial health and stability of your organization.

OXFORD BANK