Meta title: What is a cash flow ratio? |Touch Financial

Meta Description: We explore what a cash flow ratio is, the different cash flow ratios, and how to use them to assess your financial health.

What is a cash flow ratio?

A cash flow ratio is a financial metric that provides insight into a business's ability to pay off its current debts with cash generated in the same period. Several cash flow ratios are used to uncover crucial information about business performance, and in this quick guide, we explore all of them in detail.

<h2>Types of cash flow ratios</h2>

There are six cash flow ratios, namely:

<h3>1. Current liability coverage ratio</h3>

The current liability coverage ratio calculates how much cash you have to pay off debt and measures your liquidity. A ratio greater than one shows you are generating enough cash to meet your obligations.

How it's calculated: Cash flow from operations divided by current liabilities.

<h3>2. Cash flow coverage ratio</h3>

The cash flow coverage ratio measures how much cash you generate annually to pay off your total outstanding debt. A ratio of greater than one indicates that you're not at risk of default. Because this ratio shows sufficient cash flow to pay off debt plus interest, it should be as high as possible.

How it's calculated: Net operating cash flow divided by total debt.

<h3>3. Price-to-cash-flow ratio</h3>

The price-to-cash-flow ratio measures how much cash you generate relative to your stock price and helps determine your company's value. Unlike the cash flow ratios we've covered so far, the price-to-cash flow ratio should be low. This is because a higher ratio implies that your stock price is high relative to how much cash you generate.

How it's calculated: Share price divided by operating cash flow per share.

<h3>4. Cash interest coverage ratio</h3>

The cash interest coverage ratio measures your ability to pay off the interest on your outstanding debt. A higher ratio is more favourable as it means you'll have no difficulty meeting your interest payment obligations.

How it's calculated: Earnings before interest and taxes divided by interest.

<h3>5. Operating cash flow ratio</h3>

The operating cash flow ratio compares your operating cash flow to your current liabilities. As it shows how much cash you have to cover your short-term obligations, a higher ratio is preferable.

How it's calculated: Operating cash flow divided by liabilities.

<h3>6. Cash flow to net income</h3>

The cash flow to net income ratio compares your operating cash flow to your net income. Because it provides insight into how well you're converting net income into cash flow, a higher ratio is a positive sign.

How it's calculated: Operating cash flow divided by net income.

<h2>Interpreting cash flow ratios</h2>

Cash flow ratios play a crucial role in financial analysis, as they provide insight into your company's liquidity, solvency, and long-term sustainability. Except for the price-to-cash flow ratio, which should be low, higher cash flow ratios are preferable.

Comparing your cash flow ratios to those of competitors or industry benchmarks may help you identify issues in your relative financial performance. However, it's always advisable to use cash flow ratios with other financial metrics to get a complete picture of your company's financial standing.