HOW TO GET THE MOST VALUE FROM RMA’S ANNUAL STATEMENT STUDIES®:
UNDERSTANDING COVERAGE RATIOS

PART 5 IN A SERIES OF 7 GUIDES

Enterprise Risk • Credit Risk • Market Risk • Operational Risk • Regulatory Affairs • Securities Lending
RMA’s Annual Statement Studies: Financial Ratio Benchmarks features 19 of the most widely used ratios in the financial services industry, including various types of liquidity, coverage, leverage, and operating ratios.

On each data page of the Financial Ratio Benchmarks book, below the common size balance sheet and income statement information, you will find a series of ratios computed from the financial statement data.

The information in this document will explain coverage ratios and how to calculate related ratios.

**COVERAGE RATIOS**

Coverage ratios measure a firm’s ability to service its debt. In other words, how well does the flow of a company’s funds cover its short-term financial obligations? In contrast to liquidity ratios that focus on the possibility of liquidation, coverage ratios seek to provide lenders a comfort level based on the belief the firm will remain a viable enterprise.
1. EARNINGS BEFORE INTEREST AND TAXES (EBIT)/INTEREST

<table>
<thead>
<tr>
<th>HOW TO CALCULATE:</th>
<th>Divide earnings (profit) before annual interest expense and taxes by annual interest expense.</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Earnings before Interest and Taxes</td>
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<td>Annual Interest Expense</td>
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| HOW TO INTERPRET: | This ratio measures a firm’s ability to meet interest payments. A high ratio may indicate that a borrower can easily meet the interest obligations of a loan. This ratio also indicates a firm’s capacity to take on additional debt. |

Note:
Only statements reporting annual interest expense were used in the calculation of this ratio. The ratio values are arrayed from the highest positive to the lowest positive and then from the lowest negative to the highest negative.
2. NET PROFIT + DEPRECIATION, DEPLETION, AMORTIZATION/CURRENT MATURITIES LONG-TERM DEBT

<table>
<thead>
<tr>
<th>HOW TO CALCULATE:</th>
<th>Add net profit to depreciation, depletion, and amortization expenses. Then, divide by the current portion of long-term debt.</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Net Profit + Depreciation, Depletion, Amortization Expenses</td>
</tr>
<tr>
<td></td>
<td>Current Portion of Long-term Debt</td>
</tr>
</tbody>
</table>

| HOW TO INTERPRET: | This ratio reflects how well cash flow from operations covers current maturities. Because cash flow is the primary source of debt retirement, the ratio measures a firm’s ability to service principal repayment and take on additional debt. Even though it is a mistake to believe all cash flow is available for debt service, this ratio is still a valid measure of the ability to service long-term debt. |

Note:
Only data for corporations with the following items was used:

(1) Profit or loss after taxes (positive, negative, or zero).

(2) A positive figure for depreciation/depletion/amortization expenses.

(3) A positive figure for current maturities of long-term debt.

Ratio values are arrayed from the highest to the lowest positive and then from the lowest to the highest negative.
How to Get the Most Value from RMA’s Annual Statement Studies*:  
Understanding Coverage Ratios  
(#5 in a series of 7 Guides)

For additional Annual Statement Studies Guides in this series, please visit http://landing.rmabq.org/SSGuides.

For more information about RMA’s Annual Statement Studies: Financial Ratio Benchmarks or to purchase your copy today, please visit www.rmabq.org/annual-statement-studies/.
How to Get the Most Value from RMA’s Annual Statement Studies:
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About RMA

The Risk Management Association (RMA) is a not-for-profit, member-driven professional association serving the financial services industry. Its sole purpose is to advance the use of sound risk management principles in the financial services industry. RMA promotes an enterprise approach to risk management that focuses on credit risk, market risk, operational risk, securities lending, and regulatory issues.

Founded in 1914, RMA was originally called the Robert Morris Associates, named after American patriot Robert Morris, a signer of the Declaration of Independence. Morris, the principal financier of the Revolutionary War, helped establish our country’s banking system.

Today, RMA has approximately 2,500 institutional members. These include banks of all sizes as well as nonbank financial institutions. RMA is proud of the leadership role its member institutions take in the financial services industry. Relationship managers, credit officers, risk managers, and other financial services professionals in these organizations with responsibilities related to the risk management function represent these institutions within RMA. Known as RMA Associates, these 18,000 individuals are located throughout North America and financial centers in Europe, Australia, and Asia.

RMA University

In today’s rapidly changing financial services industry, you need practical, day-to-day knowledge that will help you excel in your profession. RMA provides quality education to advance sound risk principles in the financial services industry. Traditional classroom training and online learning resources are available as open enrollments or in-bank training. Visit RMA’s event calendar at https://www.rmahq.org/eventcalendar.aspx to find out what’s available, or learn about RMA’s online resources at http://www.rmahq.org/rma-university-online/

eStatement Studies

RMA’s eStatement StudiesSM is the only source of comparative data that comes directly from the financial statements of small and medium-size business customers of RMA’s member institutions. Round-the-clock online access gives you the ease and flexibility to use this wealth of information at your convenience. Visit http://www.rmahq.org/estatement-studies/

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