

DEBT-TO-EQUITY RATIO

1. What is the Debt-to-Equity Ratio?

The Debt-to-Equity Ratio compares a company's total liabilities to its shareholders' equity. It indicates how much debt a company uses to finance its operations relative to its equity base.

$$\text{Debt – to – Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Shareholders' Equity}}$$

EXAMPLES

Example 1st: If a company has 400.000€ in total liability and 1.000.000€ in shareholders' equity. Its debt-to-equity ratio is:

$$\text{Debt – to – Equity Ratio} = \frac{400.000\text{€}}{1.000.000\text{€}} = \mathbf{0.4}$$

Example 2nd: If another company has 1.200.000€ in debt and only 150.000€ in equity then its debt-to-equity ratio is:

$$\text{Debt – to – Equity Ratio} = \frac{1.200.000\text{€}}{150.000\text{€}} = \mathbf{8.0}$$

2. How to find the average debt-to-equity ratio in your industry?

This ratio compares interest-bearing debt to earnings before interest, taxes depreciation and amortization (EBIDTA). It is useful because it shows not only what a company owns, but how easily it can repay it based on operating performance. It is harder to calculate monthly but gives deeper insight than the basic debt-to-equity ratio.

3. What is the long-term debt-to-equity ratio?

This variation includes only long-term debt; this gives a more accurate picture of the company's core financial structure. It leaves out short-term obligations like credit lines and trades payables, which may not reflect lasting debt levels.

4. Do banks use the debt-to-equity ratio?

The answer is Yes. More specifically, banks often check this ratio when evaluating a loan application. Since it is easy to monitor, it helps them track changes in financial

stability. However, they also consider other ratios that include cash flow ratios to gain a more comprehensive understanding of financial risk.

5. What does a low or high debt-to-equity ratio mean?

The debt-to-equity ratio shows the extent to which a company is financed through borrowing in relation to its equity. A low index indicates financial stability and limited risk, as the company relies on its Equity. On the contrary, a high index, especially when it exceeds 5 or 6, indicates increased financial risk and lower creditworthiness.

6. What is optimal capital structure?

According to many experts, a balanced relationship between loans and equity is when the company borrows about €2 to €2.5 for every €1 it has from its own capital. This is considered a reasonable level of financing, as it ensures sufficient liquidity without excessively increasing financial risk.

7. What is the IBD to EBIDTA ratio?

This ratio shows how easily a business can repay its debt based on its operating profits. Although it is more complex than the debt-to-equity ratio, it is based on actual operating performance.