Inventory Turnover

Filed Under: Accounting, Balance Sheet, Financial Statements, Fundamental Analysis

Definition of 'Inventory Turnover'

A ratio showing how many times a company's inventory is sold and replaced over a period. The days in the period can then be divided by the inventory turnover formula to calculate the days it takes to sell the inventory on hand or "inventory turnover days."

Generally calculated as:

$$= \frac{\text{Sales}}{\text{Inventory}}$$

However, it may also be calculated as:

$$= \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

Investopedia explains 'Inventory Turnover'

Although the first calculation is more frequently used, COGS (cost of goods sold) may be substituted because sales are recorded at market value, while inventories are usually recorded at cost. Also, average inventory may be used instead of the ending inventory level to minimize seasonal factors.

This ratio should be compared against industry averages. A low turnover implies poor sales and, therefore, excess inventory. A high ratio implies either strong sales or ineffective buying.

High inventory levels are unhealthy because they represent an

investment with a rate of return of zero. It also opens the company up to trouble should prices begin to fall.

Things to Remember

- *A low turnover is usually a bad sign because products tend to deteriorate as they sit in a warehouse.*
- *Companies selling perishable items have very high turnover.*
- *For more accurate inventory turnover figures, the average inventory figure, ((beginning inventory + ending inventory)/2), is used when computing inventory turnover. Average inventory accounts for any seasonality effects on the ratio.*