

BUSINESS PROFITABILITY CHEAT SHEET

PROFITABILITY RATIOS

Assess a business's ability to generate earnings relative to its revenue, operating costs, balance sheet assets, or shareholders' equity over time, using data from a specific point in time.

Return on Assets (ROA)

The higher the ROA number, the better, because the company is earning more money on less investment.

$$\text{RETURN ON ASSETS} = \frac{\text{NET INCOME}}{\text{TOTAL ASSETS}}$$

Return on Equity (ROE)

A steadily increasing ROE is a hint that management is giving shareholders more for their money.

$$\text{RETURN ON EQUITY} = \frac{\text{NET INCOME}}{\text{SHAREHOLDERS' EQUITY}}$$

Return on Investment (ROI)

If an investment's ROI is net positive, it is probably worthwhile.

$$\text{ROI} = \frac{\text{CURRENT VALUE OF INVESTMENT} - \text{COST OF INVESTMENT}}{\text{COST OF INVESTMENT}}$$

Return on Invested Capital (ROIC)

An ROIC higher than the cost of capital means a company is healthy and growing, while the opposite suggests an unsustainable business model.

$$\text{ROIC} = \frac{\text{NET INCOME} - \text{DIVIDENDS}}{\text{DEBT} + \text{EQUITY}}$$

EBITDA Margin

The higher a company's EBITDA margin is, the lower its operating expenses are in relation to total revenue.

$$\text{EBITDA MARGIN} = \frac{\text{EARNINGS BEFORE INTEREST AND TAX} + \text{DEPRECIATION} + \text{AMORTIZATION}}{\text{TOTAL REVENUE}}$$

Net Profit Margin

Shows how much profit is generated from every \$1 in sales, after accounting for all business expenses involved in earning those revenues.

$$\text{NET PROFIT MARGIN} = \frac{\text{NET INCOME}}{\text{REVENUE}} \times 100$$

Operating Margin

Shows how much earnings from operations is generated from every \$1 in sales after accounting for the direct costs involved in earning those revenues.

$$\text{OPERATING MARGIN} = \frac{\text{OPERATING EARNINGS}}{\text{REVENUE}}$$

LIQUIDITY RATIOS

Determine a debtor's ability to pay off current debt obligations without raising external capital. Liquidity ratios measure a company's margin of safety by calculating metrics.

Current Ratio

A company with a current ratio of less than 1.00 does not, in many cases, have the capital on hand to meet its short-term obligations if they were all due at once.

$$\text{CURRENT RATIO} = \frac{\text{CURRENT ASSETS}}{\text{CURRENT LIABILITIES}}$$

Quick Ratio

A company that has a quick ratio of less than 1 may not be able to fully pay off its current liabilities in the short term.

$$\text{QUICK RATIO} = \frac{\text{CURRENT ASSETS} - \text{INVENTORY} - \text{PREPAID EXPENSES}}{\text{CURRENT LIABILITIES}}$$

Cash Ratio

If a company's cash ratio is less than 1, there is insufficient cash on hand to pay off short-term debt.

$$\text{CASH RATIO} = \frac{\text{CASH} + \text{CASH EQUIVALENTS}}{\text{CURRENT LIABILITIES}}$$

Operating Cash Flow Ratio

A measure of how readily current liabilities are covered by the cash flows generated from a company's operations.

$$\text{OPERATING CASH LOW RATIO} = \frac{\text{OPERATING CASH FLOW}}{\text{CURRENT LIABILITIES}}$$

Receivable Turnover Ratio

A low receivables turnover ratio might be due to an inadequate collection process, bad credit policies, or customers that are not financially viable or creditworthy.

$$\text{RECEIVABLE TURNOVER} = \frac{\text{NET CREDIT SALES}}{\text{AVERAGE ACCOUNTS RECEIVABLE}}$$

Inventory Turnover

A low turnover implies weak sales and possibly excess inventory, also known as overstocking.

$$\text{INVENTORY TURNOVER} = \frac{\text{COST OF GOODS SOLD}}{\text{AVERAGE VALUE OF INVENTORY}}$$

Working Capital Turnover

A high working capital turnover ratio shows a company is running smoothly and has limited need for additional funding.

$$\text{WORKING CAPITAL TURNOVER} = \frac{\text{NET ANNUAL SALES}}{\text{AVERAGE WORKING CAPITAL}}$$

SOLVENCY RATIOS

Measure an enterprise's ability to meet its long-term debt obligations. A solvency ratio indicates whether a company's cash flow is sufficient to meet its long-term liabilities and thus measures its financial health.

Debt-To-Equity Ratio (D/E)

A high D/E ratio is often associated with high risk; it means that a company has been aggressive in financing its growth with debt.

$$\text{DEBT/EQUITY} = \frac{\text{TOTAL LIABILITIES}}{\text{TOTAL SHAREHOLDERS' EQUITY}}$$

Total-Debt-To-Total-Assets-Ratio

A ratio greater than 1 shows that a considerable portion of the assets is funded by debt.

$$\text{TD/TA} = \frac{\text{SHORT TERM DEBT} + \text{LONG TERM DEBT}}{\text{TOTAL ASSETS}}$$

Interest Coverage Ratio

When a company's interest coverage ratio is only 1.5 or lower, its ability to meet interest expenses may be questionable.

$$\text{INTEREST COVERAGE RATIO} = \frac{\text{EARNINGS BEFORE INTEREST AND TAXES}}{\text{INTEREST EXPENSE}}$$

Shareholder Equity Ratio

When a company's shareholder equity ratio approaches 100%, it means that the company has financed almost all of its assets with equity capital instead of taking on debt.

$$\text{SHAREHOLDER EQUITY RATIO} = \frac{\text{TOTAL SHAREHOLDER EQUITY}}{\text{TOTAL ASSETS}}$$

