UNIT-3

FUNDAMENTAL ANALYSIS

3.6 MEASURING EARNINGS

Measuring earnings is a fundamental aspect of assessing the financial performance and health of a company. Earnings are a key indicator of a company's profitability and are used by investors, analysts, and stakeholders to make informed decisions. Here are several common metrics and methods for measuring earnings:

Net Income:

Net income, also known as net profit or earnings, is the most straightforward measure of a company's profitability. It is calculated by subtracting all expenses, taxes, and interest from total revenue. Net income is reported on a company's income statement.

Net Income =Total Revenue − Total Expenses

Earnings Per Share (EPS):

Earnings per share is a widely used metric that represents the portion of a company's profit allocated to each outstanding share of common stock. It is calculated by dividing net income by the number of outstanding shares.

EPS = Net Income/Number of Outstanding Shares

Operating Income:

Operating income, also known as operating profit or operating earnings, excludes non-operating expenses like interest and taxes. It provides a measure of a company's core profitability from its primary business activities.

Operating Income = Total Revenue − Operating Expenses

Earnings Before Interest and Taxes (EBIT):

EBIT is a measure of a company's profitability that excludes interest and taxes. It is useful for comparing the operating performance of companies with different tax structures or financial leverage.

EBIT = Total Revenue − Operating Expenses (excluding interest and taxes)

Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA):

EBITDA is a measure that adds back depreciation and amortization to EBIT. It provides a view of a company's ability to generate operating income without the impact of non-cash expenses.

EBITDA = EBIT + Depreciation + Amortization

Gross Profit:

Gross profit measures a company's profitability from its core operations by subtracting the cost of goods sold (COGS) from total revenue.

Gross Profit = Total Revenue − Cost of Goods Sold (COGS)

Profit Margin:

Profit margin is a ratio that expresses a company's net income as a percentage of its total revenue. It provides insight into how efficiently a company is converting sales into profits.

Profit Margin = (Net Income/Total Revenue)×100

Return on Equity (ROE):

ROE measures a company's ability to generate profit from shareholders' equity. It is calculated by dividing net income by shareholders' equity.

ROE = Net Income/Shareholders' Equity

Free Cash Flow (FCF):

While not a direct measure of earnings, free cash flow is essential for understanding a company's ability to generate cash after accounting for operating expenses and capital expenditures.

FCF = Operating Cash Flow − Capital Expenditures

These metrics provide a comprehensive view of a company's earnings and financial performance. Analysts often use a combination of these measures to gain a more nuanced understanding of a company's profitability, operational efficiency, and overall financial health.