CHAPTER FOUR NOTES

- Profitability ratios- group of ratios that show the combined effects of liquidity, asset management, and debt management on operation results. (formulas in notebook)
    - Operating Margin- measures operating income EBIT per dollar of sales
        - EBIT/Sales
        - EBIT= Earnings before interest and taxes
    - Profit Margin or Net Profit Margin- measures the net income per dollar of sales
        - Net income/sales
    - Return on Total Assets= net income/total assets
    - Return on Common Equity- measures the rate of return on common stockholders' investments
        - Net income/common shareholder equity
    - Return on Invested Capital (ROIC)- measures the <u>total return</u> that a company has provided for its investors.
        - EBIT (1-T)/Total Invested Capital
        - Total invested capital includes debt and equity
- Basic Earnings Power Ratio (BEP)- measures the raw earnings power of the firm's assets before the influence of taxes and debt; indicates the ability of the firm's assets to generate operating income
    - EBIT/Total Assets
- Market Value Ratios- relate the stock price to earnings and book value; used in three major ways: by investors, by investment banks, or firm itself.
    - P/E Ratio- shows the dollar amount investors will pay for one dollar of earnings
        - Price per share/Earnings per share
    - Market to Book Ratio- ratio of stocks market price to its book value
        - Step 1: common equity/ shares outstanding=book value per share
        - Step 2: market price per share/ book price per share
- Dupont Formula- a way to calculate a firm's ROE
    - ROE= Net income/Common Equity
    - ROE= Profit Margin x Total asset Turnover x Equity Multiplier → (net income/sales) x (sales/total assets) x (total assets/ common equity)→ net income/ common equity
    - Firm 12.5%= 3.92% x 1.5x x 2.13x
    - Industry 15%= 5.0% x 1.8x x 1.67x