Key Terms

Profit
Profit is generally defined as excess of income or revenue over the expenses. Profit is always is determined for a particular period.

Accrual Principle
Transactions should be recorded independent of actual payment or receipts.

Matching Principle
Profit should be determining by deducting the corresponding expenses. Expenses should be charged for the period of the benefit.

Accounting Profit
Accounting profit is the profit shown by the financial statements prepared on the basis of the GAAP.

Gross Profit Ratio:
This is also called gross margin. Gross profit is the excess of sales over the cost of goods sold (COGS). Gross profit ratio shows the relationship between gross profit and sales.

Operating Profit Ratio:
Operating Profit is the excess of gross profit over the operating expenses, depreciation, and amortisation. It is calculated by dividing Operating Profit by Sales.

Total Sources
Total sources is the summation of all sources. It shows the funds raised from all sources: shareholders, outsiders and the money generated from the business.

Capital Employed
Capital employed is summation of all long term sources. Capital employed = Owners Funds + Long Term Funds or Capital employed = Total sources – Current liabilities.

Owners Fund
Owners money is money contributed by the owners (shareholders) and the money generated by the business after meeting all expenses including interest. Owners fund = Capital + Reserves and Surplus or Owners fund = Total Assets – Outsiders money.

Profit Generating Ability
Profit generating ability shows the ability of the company to use the resources to generate income to meet the expenses and leave some return for the investors: loan givers and capital givers.

Return on Total Assets (ROTA)
It is the relationship between PBIT and total assets. ROTA is calculated as ROTA = PBIT/Total Assets.

Return on Capital Employed (ROCE)
This ratio shows the money available for long term investors (equity and debt) and other statutory payments like tax. ROCE is calculated as follows:ROCE = PBIT/Capital Employed.

Profit Distributing Ability
Profit distributing ability shows the money that a company generates which can be distributed among the equity shareholders.

Return on Owners Fund or Net worth (RONW)

This ratio shows the money available for the equity shareholders and is calculated as RONW = (PAT – Preference Dividends)/Net-worth. PAT is profit after tax.

Earnings Per Share (EPS)

EPS is a variation of RONW. It shows the earnings or profit available per share. It is calculated as follows:EPS = RONW = (PAT – Preference Dividends)/Number of equity shares

Basic EPS

Basic earnings per share should be calculated by dividing the net profit or loss for the period attributable to equity shareholders by the weighted average number of equity shares outstanding during the period.

Diluted EPS

Diluted EPS takes into account the potential equity shares. For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

DuPont Analysis

Dupont analysis provides the framework to understand the drivers of ROI. In DuPont analysis, an effort is made to decompose ROI and go to the root cause of ROI. We undertake the DuPont analysis by taking any variation of ROI, viz ROTA, ROCE, or RONW.

Economic Value Added

EVA is excess of NOPAT over the capital charge. EVA measures whether the operating profit is enough compared to the total costs of capital employed.

Cost of capital

Cost of capital or Weighted average cost of capital (WACC) is the average cost of both equity capital and interest bearing debt.

Equity Equivalents

Accounting adjustments required to convert accounting profit or accounting capital into economic profit or economic capital. Such adjustments reflect the deviations from GAAP.