Revenue is the income generated from normal business operations. Revenue can also be excluding deductions of interest and tax.

Operating profit is the total earnings from a company's core business operations, used to show the company's definitive bottom line.

Net income after taxes is an accounting term most often found in an annual report, and financial performance of a company.

An income statement is one of the three major financial statements that report a company's financial performance over a specific accounting period. It focuses on revenue, expenses, gains, and losses.

Horizontal analysis is used in financial statement analysis to compare historical data, and is a key indicator of the current financial condition of a company.

Horizontal Analysis: What It Is vs. Vertical Analysis

Understanding Quality of Earnings

Quality of Earnings: Definition, Analysis, and Why It's Important

How Quality of Earnings Works

A company's quality of earnings is revealed by dismissing any accounting tricks, or one-time events that may skew the real bottom-line numbers on performance. Once these are removed, the earnings that are derived from higher sales or lower costs can be seen clearly.

A company's quality of earnings stick with the GAAP conventions. The only way to make earnings appear more attractive is by inflating those numbers, or by reducing them.

Some companies manipulate earnings downward to reduce the taxes they owe. They do this by writing off asset write-downs, or by taking other one-time adjustments to net income. It might not be obvious whether the company is artificially inflating earnings or not, because they are not violating any rules of good accounting. This can make financial statement analysis complicated for investors.

A company can manipulate popular earnings measures such as earnings per share. In fact, many companies do this with the goal of improving their share price. All earnings measures have their uses, but they can be manipulated to attract attention, and every investor should be aware of this.

The metric is verifiable, free from error or bias, and accurately reflects the current financial condition of a company. However, many factors can affect a company's earnings, and not all of these factors are controllable or manipulable.

How to Evaluate the Quality of EPS

One number that analysts like to track is earnings per share (EPS). It defines exactly how many dollars of profits were earned per share of common stock. It is primarily used by individual investors, who are interested in the price-to-earnings (P/E) ratio, which is the ratio of stock price per share to earnings per share. Analysts use EPS to determine whether earnings are growing, whether the company is making a profit, whether it is generating enough profit, and whether the company is executing well.

Earnings per share (EPS) is a helpful tool for evaluating the earnings performance of a company, but it can be misleading too. For instance, companies that report high sales growth may also show higher earnings growth, and this may skew a comparison of earnings growth against the growth in sales.

The Securities and Exchange Commission (SEC) requires companies to include a reconciliation of adjusted earnings per share (EPS) with the statutory amounts. This reconciliation is an adjustment that a company makes to its earnings per share figures to remove one-time events and extraordinary items, and to allow investors to figure out the true earnings per share. When companies report EPS, they are required to report both the EPS calculated under generally accepted accounting principles (GAAP) and the adjusted EPS.

It's important to look at the quality of earnings, and to compare it to the GAAP earnings. Quality of earnings is a combination of the many factors that affect a company's earnings. It's a measure of how well a company is doing, and how reliable any earnings numbers are.

What Is Quality of Earnings?

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Examples of Earnings Manipulation

Companies can manipulate earnings by using aggressive accounting conventions or one-time adjustments. For instance, companies can manipulate earnings by writing off asset write-downs, or by taking other one-time adjustments to net income. It might not be obvious whether the company is artificially inflating earnings or not, because they are not violating any rules of good accounting. This can make financial statement analysis complicated for investors.

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How Quality of Earnings is Calculated

Net income is a good way to measure a company's financial performance. It is the key component of an income statement. However, it's important to look at the quality of earnings, and to compare it to the GAAP earnings. Quality of earnings is a combination of the many factors that affect a company's earnings. It's a measure of how well a company is doing, and how reliable any earnings numbers are.

One-time adjustments to net income, also known as nonrecurring income or extraordinary items, are adjustments that are not expected to recur in the future, and that are excluded from easiness of earnings. These items can be positive or negative, and they can affect a company's financial performance in the short term, but they are not expected to recur in the future.

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