

# Glossary of Financial Terms and Ratios

## Financial Reports

**Annual report:** A document sent to shareholders that communicates a public company's version of operations and performance. Information includes earnings, revenues, balance sheet data, an auditor's statement, and management's discussion of the company's track record and future direction.

**10-K:** The official version of a public company's annual report, filed with the SEC. The company must leave speculation behind and make only provable statements of fact. Generally includes more financial information and expanded descriptions of the company's operations and the risks it faces.

**10-Q:** A public company's quarterly report, filed with the SEC. This document contains earnings, revenues, and other financial data for the most recent quarter and the year to date. Offers an updated snapshot of the company's performance

## Financial Statements

**Balance sheet:** An official financial statement that includes a company's assets (things it owns, such as cash, capital equipment, and investments) and liabilities (things it owes such as accounts payable and long-term debt). You can use a company's balance sheet to determine its financial health.

**Cash Flow Statement:** A measure of the cash receipts and cash payments a company makes over a given time period. If a company has negative cash flow, the company must borrow money to operate its business. If a company has positive cash flow, the company has money available to spend on research and development, to expand operations, and to pay dividends to investors.

**Income Statement:** A financial statement of a company's operations. The income statement shows a company's revenues, expenses, and income for a period of time such as a year or a quarter. Figures for the same period in the previous year usually are included for easy comparison. Included in a company's annual and quarterly reports, the 10-K or 10-Q.

## Analysis of Financial Statements

**Asset:** An asset is something you own, such as cash, real estate, stocks, and bonds. In the case of a business, assets also include inventory. On a balance sheet, assets contribute to the positive side, and liabilities contribute to the negative side.

**Liability:** Liability is any legally enforceable obligation.

**Net income:** The amount of a company's total sales (revenue) remaining after subtracting all of its costs, in a given period of time (also referred to as "net earnings"). This very important figure (literally the source of the term "the bottom line" for where you find it on an income statement) is the best measure of the current operating state of a company. Earnings per share (or "EPS") is found by dividing this figure by the number of share of common stock outstanding.

**Stockholders' Equity (a.k.a. "Shareholder's Equity"):** What shareholders own after a company pays off its liabilities. Stockholders' equity appears as a section on corporate balance sheet and includes capital stock, paid-in capital, and retained earnings. This section also usually indicates how many shares of stock are outstanding and how many are authorized for issue. Total liabilities plus stockholder equity equals a company's total assets.

## Markets/Indices

**Dow Jones industrial average (DJIA):** Often known as "the Dow", one of the most frequently quoted market indexes in the news. It refers to a weighted average of 30 widely-traded blue chip stocks (seasoned companies such as IBM and Coca-Cola). Because these stocks are in a variety of sectors and are actively traded, this is considered a good reflection of the market as a whole.

**NASDAQ:** The second largest stock market in the United States. Includes many major technology stocks, including Microsoft and Intel; as such, it often looked to a measure of conditions in the technology industry.

**New York Stock Exchange (NYSE):** The largest stock exchange in the world and one of the oldest, where traders buy and sell securities. It has the most rigorous listing requirements of any U.S. market, looking at a company's financial strength, its position in its industry, and the direction of the industry.

**Russell 2000:** A market index considered to represent the market of small cap stocks (market value < \$3.5 billion).

**S&P 500:** An index of 500 large capitalization domestic (US) stocks that represents the overall stock market. The S&P 500 is the most widely followed benchmark for portfolio performance. When investors refer to their portfolio or mutual fund beating the S&P, they mean that their investments are earning a better return than the S&P 500 index.

**Securities and Exchange Commission (SEC):** A federal agency that regulates federal securities laws, including the trading of public company securities, the firms that handle these transactions, and most professionals who provide investment advice.

## Securities

**Bond:** A type of security that pays a fixed amount of interest at a regular interval over a certain period of time. Bonds are essentially loans given to companies and government entities who promise to pay back the loan at a specified interest rate. Bonds are considered less risky investments than stocks.

**Capital gain:** The difference between an asset's purchase price and its selling price. (The difference is called a "capital gain" only if it's a positive amount.). A capital loss occurs when the selling price of an asset is below the purchase price.

**Dividend:** An amount of money (or stock) that a corporation pays to its shareholders quarterly. Typically, only larger companies pay dividends; smaller companies need to re-invest their own profits to grow.

**Earnings:** A corporation's profits.

**Earnings Growth:** The annualized growth rate of company profits, normally over a period of time (3 years, 5 years or 10 years). Often used as a rubric for future growth. Investors are willing to pay a premium for stocks of companies that are growing earnings (profits) quickly.

**Equity:** Ownership. For example, if you own 3,000 shares of Company XYZ's stock, that is your "equity" in the corporation.

**Futures contract:** An agreement to buy or sell a set amount of an investment instrument or commodity at a certain price by a certain date. Unlike options trading, in which investors have a choice whether to exercise their options, both buyers and sellers of futures are required to fulfill their part of the contract (unless one of them sells their contracts to another investor).

**Initial public offering (IPO):** The first time a company sells shares of its stock to the public. Also known as going public, an IPO can generate funds for debt repayment, acquisitions, and a host of other uses.

**Market capitalization ("Market Cap"):** The total number of a company's shares multiplied by the current price per share. For example, if a company has 100 million shares, and the current price per share is \$20, then the company's market capitalization is \$2 billion (\$20 x 100 million).

- **Large-cap stock** : Market cap over \$5 billion
- **Mid-cap stock** Market cap between \$1 billion and \$5 billion
- **Small cap stock:** Market cap under \$3.5 billion

**Option:** The right to buy or sell an investment instrument, usually a security (stock or bond), at a previously agreed price known as the strike price. The option buyer or seller pays a premium to lock in the price of the underlying investment without initially having to buy or sell the investment.

**Preferred Stock:** A stock with a fixed dividend that is paid before common stock dividends. Preferred stockholders do not have voting rights. Prices of these stocks are volatile because these shares are thinly traded compared to common stock

**Share price:** The price of a unit of ownership in a company (a share). The most recent trade in the stock is typically used as the "quoted" share price. You can arrive at market capitalization by multiplying share price times total shares outstanding for a particular company.

**Stock (a.k.a. "common stock"):** A share of ownership, or equity, in a corporation. Common stockholders have voting privileges. For example, if you buy 10,000 shares in a company with 1 million shares outstanding, you own 1% of the company.

## Financial Ratios

**Current ratio:** A company's current assets (typically cash + receivables + inventory) divided by its current liabilities (debt due within a year). This ratio gives you a sense of a company's ability to meet short-term liabilities, and is a measure of financial strength in the short term. A ratio of 1 implies adequate current assets to cover current liabilities: the higher above 1, the better.

**Debt-equity ratio:** The ratio of a company's liabilities (debts) to its equity (total value of its stock). The higher the level of debt, the more important it is for a company to have positive earnings and steady cash flow. For comparative purposes, debt-equity ratio is most useful for companies within the same industry.

**Dividend yield:** The result of amount of [dividends](#) per share divided by a stock's current market price. For example, if a stock's current price is \$50, and the company pays a \$5.00 [dividend per share](#) (dividends/shares outstanding) per year, then the dividend yield is 10 percent ( $5/50 = 0.10$ , which equals 12.5%).

**Earnings per share ("EPS"):** The net income (or [earnings](#)) of a company for the past 12 months divided by the current number of shares. For example, if a company has \$50 million in net income and has 20 million outstanding shares, then its "earnings per share" is \$2.50 ( $50/20$ ). Many investors consider this an important fundamental to consider when deciding whether to buy or sell a stock.

**Price/Earnings Ratio ("P/E"):** An indicator of a stock's value. To calculate a price-earnings ratio, divide the stock's price by its earnings per share for a 12-month period. For example, if a stock is selling for \$30 and is earning \$3 a share, its P/E ratio is 10 ( $30/3$ ). Stocks with [high P/Es](#) compared to the overall market are typically growth stocks. Investors are willing to pay a premium because they expect the company's earnings and stock price to rise. Stocks with [low P/Es](#) are sometimes considered overlooked value stocks. Because earnings are volatile, and sometimes "negative," the P/E has its limitations and may fail as a measure for a significant number of stocks at any given time.

**Profit margin:** Determined by dividing [net income](#) by [net sales](#) during a time period (usually the past four quarters) and is expressed as a percentage. Net profit margin is a [measure of efficiency](#) and the higher the margin, the better. Trends in margin can be attributed to rising/falling production costs or rising/falling price of the goods sold

**Return:** The profit earned on an investment, usually expressed as an [annual percentage rate](#) (APR). [Total return](#) includes security price appreciation plus any dividend/interest payments. For example, if a stock price moves from \$10/share to \$15/share in one year, the [return](#) is \$5, or 50% ( $\$5/\$10$ ); if that same stock also pays a \$1/share dividend, the return is \$5 (share appreciation) + \$1 (dividend) = \$6/share. The total return is found by dividing the appreciation + dividend (\$6/sh) by the beginning purchase price:  $(6/10) = 60\%$ .

**Return on assets ("ROA"):** The amount of profits earned (before interest and taxes), expressed as a percentage of [total assets](#). This is a widely followed measure of profitability, thus the higher the number the better. As long as a company's ROA exceeds its interest rate on borrowing, it's said to have positive financial leverage.

**Return on equity ("ROE"):** A percentage that indicates how well common stockholders' invested money is being used. The percentage is the result of dividing [net earnings](#) by common stockholders' [equity](#). The ROE is used for measuring growth and profitability. You can compare a company's ROE to the ROE of its industry to determine how a company is doing compared to its competition.

**Return on investment ("ROI"):** Also known as return on invested capital (ROIC). ROI is a measure of how well management has used the company's resources. ROI is calculated by dividing earnings by total assets. It is a broader measure than [return on equity](#) (ROE) because assets include debt as well as equity. It is useful to compare a company's ROI with others in the same industry.