Profitability Ratios (SL/HL)

Gross Profit Margin formula:

$$Gross\ profit\ margin = \frac{gross\ profit}{sales\ revenue} \times 100$$

Definition

The gross profit margin is the profit that remains in the businesses after subtracting all the costs of goods sold. It indicates the percentage of each dollar of revenue that the company retains as profit. One of the main uses it has is that it helps a company assess its profitability of overall manufacturing.

Example

For example, if a business makes $20,000 by selling machines. It costs $8,000 to manufacture those machines. The gross profit would be $12,000. To calculate the Gross profit margin:

$$Gross\ profit\ margin = \frac{\$12{,}000}{\$20{,}000} \times 100 = 60\%$$

Net Profit Margin formula:

$$NPM = \frac{net\ profit\ b4\ interest\ and\ tax}{sales\ revenue} \times 100$$

Definition

The net profit margin is the percentage of income that a business keeps after all the expenses and taxes are paid. It shows how much profit is generated from every dollar of sales, after counting for all expenses. Businesses use this to help investors see if a business is generating enough income, and if costs are under control.

Example

For example, if a business sales are $1,000,000 from computers, and your profit before interest and tax is $100,000 the net profit margin is:

$$Net\ profit\ margin = \frac{\$100{,}000}{\$1{,}000{,}000} \times 100 = 10\%$$