

Terminology – The Income Statement

Amortization: A non-cash expense related to the loss in value of an *intangible* asset. The concept is similar to Depreciation, except that in this case it is for an intangible asset such as intellectual property (copyrights, patents), licenses, and goodwill.

Cost of Goods Sold: Also known as COGS, or sometimes as the “Cost of Sales”. The cost of goods sold refers to the costs of producing the products, such as Direct Labor, Direct Materials and Manufacturing Overhead.

Depreciation: A non-cash expense related to the loss in value of a *physical* asset over its useful life.

Dividends: A payment to shareholders made from the company’s profits, specifically its net income.

Dividend Yield: The rate of return a shareholder receives from dividends. The dividend yield is determined from:

$$\text{Dividend Yield (\%)} = (\text{Dividend} / \text{Share Price}) \times 100$$

Earnings Per Share (Basic): Often referred to as EPS. The earnings per share is the net income of the company expressed on a per share basis. The “Basic” EPS is determined from the net income divided by the number of shares of common stock outstanding, meaning the number of shares that trade on the market exchanges (i.e., NASDAQ or NYSE):

$$\text{EPS} = \text{Net Income} / \# \text{Shares of Common Stock Outstanding}$$

Earnings Per Share Diluted: The same as EPS, but now includes the shares of common stock held by the company that would be used for employee bonuses (converting options to stock) or certain investors (converting warrants to stock).

General & Administrative (G&A) Expense: All the staff and supporting expenses necessary to run the business, including rent, management salaries, costs of HR, IT, Legal and Accounting departments.

Gross Margin: The ratio of Gross Profit to Revenues: $\text{Gross Margin (\%)} = (\text{Gross Profit} / \text{Revenues}) \times 100$. It is a reflection of the efficiency of production and/or the value of the product to the customer. High gross margins indicate highly efficient production and/or customers willing to pay relatively high prices for the product.

Gross Profit: The difference between the revenues and cost of goods sold:

$$\text{Gross Profit} = \text{Revenues} - \text{COGS}$$

Income Before Taxes: the operating profit less other income or expenses. This is the taxable income from which taxes are determined.

$$\text{Income Before Taxes} = \text{Gross Profit} - \text{Operating Expenses} - \text{Other Income/Expense}$$

Income Taxes (or Provision for Income Taxes): Companies pay income taxes like everyone else, but only on the profits it makes. This line item identifies what it paid (or will pay) in taxes based on the income before tax.

Net Income: The true bottom line. The profits, after taxes, to pay shareholders a dividend, make further investments in the company, or simply save to build a healthy cash balance.

Operating Expenses: A general category of expenses that includes all the other elements of operating the business, such as R&D, HR, Sales, Depreciation, Amortization, and G&A expenses.

Operating Income: The company's profits associated with selling its products and services.

$$\text{Operating Income} = \text{Gross Profit} - \text{Operating Expenses}$$

Operating Margin: The company's operating income as a percentage of revenues:

$$\text{Operating Margin (\%)} = (\text{Operating Income} / \text{Revenue}) * 100$$

Other Income or Expense: This represents other sources of income (or expenses) that are generally not associated with sales or costs of producing the product. Commonly these are related to interest on bank loans, proceeds from the sale of stock, etc., and other "one-time-only" ("OTO") events such as costs associated with shutting down facilities.

R&D: An operating expense related to product development.

Revenue: Also referred to as Sales. Essentially what the company earns from customers for its products and services.

Sales, General & Administrative: Commonly referred to as SG&A. A category of operating expense that includes all the staff and supporting expenses necessary to operate the business, such as salaries (for everyone other than direct labor), rent, marketing, legal and other indirect costs.