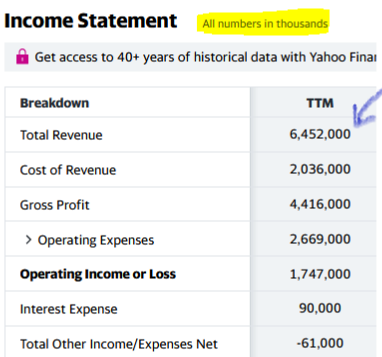
Disclaimer for those who are new to reading financial statements:

For those of you who are new to investing, keep in mind that the numbers you see on the screenshot are in thousands, meaning that “6,452,000 (6.4 million),” is actually 6,452,000,000 (6.4 billion). Numbers in thousands just means to take the number you see on screen e.g. “6,452,000” and multiply it by 1,000. Same thing goes for numbers in millions just that instead of multiplying by 1,000, you multiply by 1,000,000. The reason for this, generally, is to just show the more important digits and to make the numbers easier to read due to how big these numbers are because of how much money these companies are making. Financial statements will generally tell you whether the numbers are in thousands or in millions, like so:



**Income Statement** All numbers in thousands

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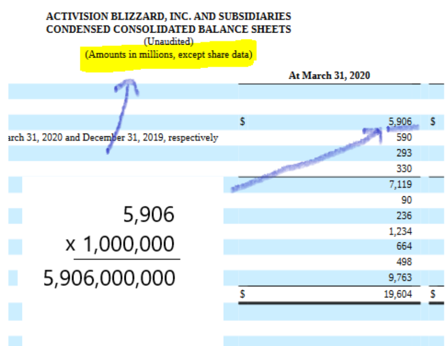
| Breakdown | TTM |
|---|---|
| Total Revenue | 6,452,000 |
| Cost of Revenue | 2,036,000 |
| Gross Profit | 4,416,000 |
| > Operating Expenses | 2,669,000 |
| **Operating Income or Loss** | 1,747,000 |
| Interest Expense | 90,000 |
| Total Other Income/Expenses Net | -61,000 |

6,452,000
x 1,000
6,452,000,000




Calculating a company’s profitability:

Calculating a company’s profitability is one of the easier calculations in my process of researching companies and there’s two things I will look out for when it comes to profitability; net profit margin and gross profit margin. The first is to simply calculate net profit margin, and it’s a really good way to gauge how good a company is at <u>converting revenue into profit</u>, or wealth. This can be easily done by going over to the company’s income statement, which can be found on websites such as Yahoo Finance or their SEC filings by either going to sec.gov or the company’s investor relations page. Either of these is fine and there’s other sites out there, but I generally stick with these two. Once you’ve gotten to the income statement, locate “Total Revenue” at the top of the income statement and “Net Income” at the bottom of the income statement. From here, you’ll simply divide the net income by the total revenue like so:

**Income Statement** All numbers in thousands

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| Breakdown | TTM | 12/31/2019 |
|---|---|---|
| Total Revenue | 6,452,000 | 6,489,000 |
| Cost of Revenue | 2,036,000 | 2,094,000 |
| Gross Profit | 4,416,000 | 4,395,000 |
| > Operating Expenses | 2,669,000 | 2,656,000 |
| **Operating Income or Loss** | 1,747,000 | 1,739,000 |
| Interest Expense | 90,000 | 90,000 |
| Total Other Income/Expenses Net | -61,000 | -95,000 |
| Income Before Tax | 1,670,000 | 1,633,000 |
| Income Tax Expense | 109,000 | 130,000 |
| Income from Continuing Operations | 1,561,000 | 1,503,000 |
| **Net Income** | 1,561,000 | 1,503,000 |
| Net Income available to common s... | 1,561,000 | 1,503,000 |
| Basic EPS | - | - |
| Diluted EPS | - | - |
| Basic Average Shares | - | - |
| Diluted Average Shares | - | - |
| EBITDA | - | 2,276,000 |

I'll be using ATVI's 12/31/2019 numbers for the calculations.

Formula:

Net Income / Total Revenue = Net Profit Margin

Plugging in the numbers:

1,561,000 / 6,452,000 = 0.2419

From here we can just round that to 0.242

So when you multiply that by 100, you'll get your percentage.

0.242 x 100 = 24.2%

Simple!

I don't often throw much money, if any at all, to companies with low profitability ratios because I just don't see the point in it. However, sometimes there will be company's I see a lot of potential for an increase in profits or I just want to know why their profits are so low. That way if a company ever announces in an earnings press release or in a future 10-K or 10-Q that they've cut back on an expense that dug into profits I'll go back and redo the calculation. But there's also another thing you can do if you want to calculate a company's core earnings potential, which is calculating the company's gross profit margin.

Gross profit margin can be found by dividing a company's gross profit by their total revenue. Gross profit is simply how much money there is left over after you subtract Cost of Goods Sold (COGS) from Total Revenue. So, if we were to take ATVI's gross profit of and divide it by total revenue we would get the following:

**Income Statement** All numbers in thousands

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|---|---|---|
| Total Revenue | 6,452,000 | 6,489,000 |
| Cost of Revenue | 2,036,000 | 2,094,000 |
| Gross Profit | 4,416,000 | 4,395,000 |
| › Operating Expenses | 2,669,000 | 2,656,000 |
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| Income from Continuing Operations | 1,561,000 | 1,503,000 |
| **Net Income** | 1,561,000 | 1,503,000 |
| Net Income available to common s... | 1,561,000 | 1,503,000 |
| Basic EPS | - | - |

Still using 12/31/2019 numbers.

Formula:

Gross Profit / Total Revenue = Gross Profit Margin

Plugging in the numbers:

4,395,000 / 6,489,000 = 0.6773

Now round it up and multiply by 100 and there you go

0.6773 x 100 = 67.8%

Awesome!

This is their core earnings potential after subtracting COGS and before subtracting other operating expenses. Again, this one isn't too complicated and it's quick, that's why I always start with it. I can sometimes decide whether or not to even continue the research if I don't like how low their profits are. For most companies, I'll typically stay away from them if they aren't able to turn much of their very high revenues into profits because chances are the business isn't being run as well as it could be. But again, this varies and can be subject to change based on future performance of the company, management decisions, etc.