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Earnings: Company Earnings Defined, With Example of Measurements

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What Are Earnings?

A company's earnings are its after-tax [net income](#). This is the company's [bottom line](#) or its [profits](#).

Earnings are perhaps the single most important and most closely studied number in a company's [financial statements](#). It shows a company's real profitability compared to the [analyst](#) estimates, its own historical performance, and the earnings of its competitors and industry peers.

Earnings are the main determinant of a public company's share price because they can be used in only two ways. They can be invested in the business to increase its earnings in the future, or they can be used to [reward stockholders with dividends](#).

KEY TAKEAWAYS

- Earnings refer to a company's profits in a given quarter or fiscal year.
- Earnings are a key figure used to determine a stock's value, especially if they are different than what analysts predicted. As a result, the numbers are subject to potential manipulation.
- A company's earnings are used in many common ratios for financial analysis, such as earnings per share and earnings yield.
- Financial ratios using earnings can be used to determine the health and stability of a company, as well as whether its stock is over- or undervalued.

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the earnings of the companies they follow to be released. Earnings are studied because they represent a direct link to company performance.

Earnings that deviate from the expectations of the analysts that follow that stock can have a great impact on the [stock](#)'s price, at least in the short term. For instance, if analysts on average estimate that earnings will be \$1 per share and they come in at \$0.80 per share, the price of the stock is likely to fall on that "earnings miss."

A company that beats analysts' earnings estimates is looked on favorably by investors. A company that consistently misses earnings estimates may be considered an unattractive and risky investment. Even if the company only needs to improve its financial forecasting abilities for better earnings guidance, its stock price may be hurt in the process.

There are exceptions to these outcomes depending on the circumstances of the company. For example, Amazon (AMZN) missed its estimates for several quarters in the early 2000s while it was building out its various business units. ^[1] Some investors were able to understand the long-term potential, and it continued to attract investors.

The opposite example is Google, a company known for underpromising and overdelivering. Hence, Google has repeatedly beat earnings expectations. However, the analysts' community understood that and started to embed Google's conservative strategy into the EPS expectations.

Generally, a new, entrepreneurial company that is seen as having strong potential can survive a few disappointing quarters, though it generally needs a good explanation for the earnings miss. As was the case for Amazon, that explanation was a heavy investment in future earnings.

Measures of Earnings

There are many measures and uses of earnings. Some analysts like to calculate [earnings before taxes](#) (EBT), also known as pre-tax income. Some analysts prefer to see [earnings before interest and taxes](#) (EBIT). Still, other analysts, mainly in industries with a high level of fixed assets, prefer to see [earnings before interest, taxes, depreciation, and amortization](#), also known as EBITDA.

All three figures provide varying degrees of measuring profitability.

Earnings per Share

[Earnings per share](#) (EPS) is a commonly cited ratio used to show the company's profitability on a per-share basis. It is calculated by dividing the company's total earnings by the number of shares outstanding.

Price-to-Earnings

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share, is used by investors and analysts to compare the relative values of companies in the same industry or sector.

The stock of a company with a high P/E ratio relative to its industry peers may be considered overvalued. A company with a low price compared with its earnings might appear to be undervalued.

Earnings Yield

The [earnings yield](#), or the earnings per share for the most recent 12-month period divided by the current market price per share, is another way of measuring earnings. It is in fact simply the inverse of the P/E ratio.

Criticism of Earnings

Since corporate earnings are such an important metric and have a direct impact on share price, managers may be tempted to manipulate earnings figures. This is both illegal and unethical.

Some companies attempt to sway investors by prominently displaying their earnings on their financial statements in order to hide deficiencies reported lower down that reveal weaknesses like dubious accounting practices or an unanticipated drop in sales. These companies are said to have a poor or weak [quality of earnings](#).

The earnings per share number may also be inflated with share [buybacks](#) or other methods of changing the number of shares outstanding. Companies can do this by repurchasing shares with retained earnings or debt to make it appear as if they are generating greater profits per outstanding share.

Other companies may purchase a smaller company with a higher P/E ratio to [bootstrap](#) their own numbers into a favorable territory.

When earnings manipulations are revealed, the accounting crisis that follows often leaves shareholders on the hook for rapidly declining stock prices.

Are a Company's Earnings the Same As Its Income?

A company's earnings are its profit in a given time period. This is the same as the net income. Earnings are different, however, than gross income, which is income before taxes and other expenses are deducted.

Where Are Earnings Listed on a Financial Statement?

Earnings are often referred to as a company's "bottom line" because they are listed on the literal bottom line of the financial statement. They are often labeled "net income" (or "net losses").

What Are Retained Earnings?

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down debt, or other necessary spending.

The Bottom Line

Earnings are the profits from a company, usually calculated over a quarter or a fiscal year. They are a key element in determining the value of a company's stock. If earnings are lower than expected, a company's stock price may go down. If they are higher than expected, the price may go up.

Earnings are a key part of many financial ratios that are used to analyze the financial stability of a company. They can also help analysts determine whether a company's stock is over- or undervalued. Because earnings are so important to the value of a company's stock, there is always the potential for the numbers to be manipulated.

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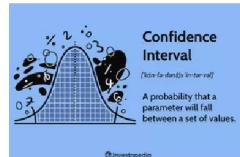
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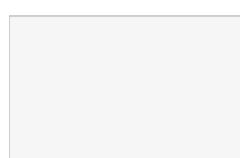
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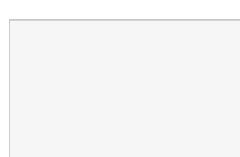
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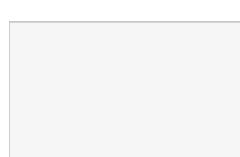
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