



Is a Stock Financially Sound? Look at its Income Statement

Description

Foolish investors know they should do sound research before investing in a stock, but what should they look at? If you want to understand the financial health of a company, look at its income statement.

What an income statement tells you

A company's income statement gives you a snapshot of the company's health. There are a number of items listed on the income statement. The most important ones to pay attention to are total revenue, total operating expenses, net income, and earnings per share.

Total revenue shows how much a stock had by way of sales for the previous quarter (or previous year, if you are looking at annual statements). This number doesn't necessarily mean much in isolation, so it's helpful to compare it to previous quarters. How does the most recent statement measure up? Has revenue increased, held steady, or decreased? If it's decreased, you want to know why. Is this just a one-off or the start of a downward spiral for the stock? The written statements that accompany the income statement should help you figure this out.

You also need to keep an eye on total expenses. It's not enough to have good revenues. You need to make sure a company isn't bleeding too much money to costs. You should also compare current expenses to previous ones. Are they holding steady, or has there been a sudden change? One specific expense to keep an eye on is research and development for newer and growing firms. Is the company putting in money to keep its fortunes up for the future, or is the company just resting on the products and services it already has?

Finally, you want to look at earnings (profit). Subtracting expenses from revenues will give you a net income or profit number. You generally want this number to be positive. You can also look at earnings per share. Does this number look good overall? Is this number higher than previous quarters, the same, or lower? Be wary of downward trends. Again, you need to see if decreases are a one-off or an ongoing problem. Earnings generally have the greatest impact on overall stock performance.

Where do you find income statements?

Publicly traded companies release earnings data quarterly and usually release year-end financials as well. You can often find them on company websites, and you can also find them on investor websites such as Google Finance when you look up a particular stock.

Let's look at the financials for **Enbridge Inc.** ([TSX:ENB](#))([NYSE:ENB](#)) as an example.

	Q2 2017	Q1 2017	Q2 2016
Revenue (in millions)	11,116.00	11,146.00	7,939.00
Expenses (in millions)	9,432.00	9,788.00	7,145.00
Net income (in millions before adjustments)	1,000.00	721.00	372.00
Earnings per share	0.56	0.62	0.33

Our chart shows the most recent second quarter for Enbridge, and we compare it to the first quarter this year and the second quarter last year. It's important to compare to another second quarter to see if a stock always has the same ups and downs each year.

In this case, revenue is down a little from the first quarter, but it's up significantly from Q2 last year. Expenses have gone down a little from the first quarter, but are also up significantly from Q2 last year. It looks like Enbridge has been doing more business and has needed to spend more money as a result. Net income (or profit) is up significantly, which is a good trend to have. Earnings per share (EPS) are down a bit from Q1 but up significantly from Q2 2016. Doing a little more digging, EPS before extraordinary items in Q2 were actually higher than Q1, so it appears uncommon expenses dragged this total down a bit. If you want to investigate more for reasons, you can read the statements that accompany the income statement.

Investor takeaway

The more information you arm yourself with, the better investing choices you will make. Researching a company's income statement will tell you a lot about a company's financial fundamentals and if it has a solid foundation. Don't make random guesses about the value of a stock. Your money is too important to waste.

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