**Bad Investment Advice**
and ways to avoid it

# The 5 Top Financial Ratios that Predict Business Success

## Return on Equity (ROE)

$$\frac{\text{Net Income}}{\text{Shareholder's Equity}}$$

Measuring Profitability and Efficiency

How efficiently a company generates profits from shareholders' investments.

Companies with consistently high ROE often demonstrate strong competitive advantages and effective capital allocation.

Warren Buffett often emphasizes ROE as a key indicator of a high-quality business.

## Free Cash Flow (FCF) Margin

$$\frac{\text{(Operating Cash Flow - Capital Expenditures)}}{\text{Total Revenue.}}$$

The Lifeblood of Growth

The cash a company generates after covering capital expenditures.

Companies with positive and growing FCF are better positioned to weather economic downturns.

High FCF margins indicate financial flexibility, allowing a company to invest in growth, pay dividends, or buy back shares.

## Debt-to-Equity Ratio

$$\frac{\text{Total Debt}}{\text{Shareholder's Equity}}$$

Assessing Financial Stability

How much a company relies on debt to finance its operations.

A low or moderate debt-to-equity ratio signals financial stability and lower risk.

Excessive debt can lead to financial distress, especially during economic downturns or rising interest rates.

## Price-to-Earnings Growth (PEG) Ratio

$$\frac{\text{P/E Ratio}}{\text{Earnings-Per-Share Growth Rate}}$$

Finding Growth at a Reasonable Price

PEG accounts for earnings growth, making it a good valuation tool for growth stocks.

A PEG ratio below 1.0 often suggests a stock is undervalued relative to its growth potential.

## Gross Margin

$$\frac{\text{(Total Revenue – Cost-of-Good-Sold)}}{\text{Total Revenue}}$$

Key Indicator of Competitive Advantage

A high gross margin indicates strong pricing power and cost efficiency.

Companies with expanding gross margins can reinvest profits into innovation and expansion.

Stable or growing gross margins suggest a durable competitive advantage.

Copyright https://badinvestmentsadvice.com/