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What is Quality of Earnings?

Companies going through a restructuring process use specialized analyses in the course of planning a new direction. One of the most important tools a company can use is called Quality of Earnings. Quality of Earnings is an assessment used to determine the ability of a company to perform given the new debt and/or equity structure that it may be undertaking. The process is designed to assess and document the strengths, weaknesses, opportunities and threats facing the company.

Further analysis is performed to determine the company’s competitive position in the marketplace, and how well it is placed for long-term success. By reviewing and evaluating the business plan, vision and strategy with short-term and long-term goals in mind, analysts can weigh the company’s preparedness for future success against the current tides in its market and predict how it will perform.

Businesses undergoing a restructuring process can use the information gained from the Quality of Earnings to create helpful tools such as specific dashboard metrics which gauge the performance of both the company and its industry along the way. An added benefit of establishing these baseline metrics is the opportunity to outline potential ‘red flags’ to look for in the reporting. For example, if certain of results fall below the identified levels, an advisor can then provide fresh recommendations to the company, its lender and/or its equity partners for overcoming obstacles to increasing operating performance and cash flow.

Quality of Earnings and other analyses also enable all the stakeholders to be better positioned to take advantage of and support growth opportunities. These reports also indicate where to deploy more capital for alignments, organic growth or acquisitions in the future.

The Quality of Earnings assessment enables stakeholders to better track performance to plan, and prepare for the future. The analysis provided in the report also provides a contingency plan should things start to trend negatively. Information is power, and in order to make better business decisions when it comes to restructuring and growth, Quality of Earnings provides crucial data not only for the lenders/investors in deciding whether or not they should invest or lend to the company but also for the owners in running and improving their business and its operations.

Courtesy: Eisner Amper