

From Verne's Insights ([www.gazelles.com](http://www.gazelles.com)): **Forget ROE or EBITDA** -- meet COROA, or "cash operating return on assets." Notes [FORTUNE in an article on this key metric](#), "What's the best, gimmick-proof way to measure how profitable companies really are? Answering that question gets to Warren Buffett's view of investing: Finding companies that consistently generate big returns on capital -- not only on the capital they manage now, but the fresh earnings that flow in each year." In essence, you want to look at the net cash the business generates each year divided by every dollar spent on the assets that produce those cash flows. There are specific rules around what to add and subtract to each of those figures, but it's an outstanding way to evaluate an investment or your own company. Have your CFO read the article and calculate the number for you. What's good? Seems like anything north of 18%.

## Top accounting guru's compelling new measure for profitability

By Shawn Tully, senior editor-at-large March 10, 2014: 10:08 AM ET

**Forget ROE or EBITDA -- and meet COROA, or "cash operating return on assets."**

FORTUNE -- A big challenge for investors is piercing management's feel-good, "it's all great if you leave out the bad stuff" earnings metrics to measure a company's true profitability. Even the official GAAP accounting numbers frequently need plenty of scrubbing to reveal the real picture. Jack Ciesielski, author of *The Analyst's Accounting Observer*, a newsletter prized by asset managers that skillfully demystifies accounting issues, has developed a fresh measure of profitability. His goal is to provide a clear view of managers' success in investing the capital entrusted to them by shareholders. He calls it "COROA," for cash operating return on assets. The idea is to measure management's ability to generate pure cash returns, not cash expected in the future, on every dollar invested in plants, R&D centers, inventories, and all other assets. "It makes sense for an investor to look at a firm's cash generation ability, relative to the cash invested it," Ciesielski wrote in the Feb. 25 edition of his newsletter, "The Analyst's Accounting Observer." For Ciesielski, it's all about cash. "What's more important in the world than cash?" he asks. "Why, it's *more* cash, of course."

The first step is ascertaining true operating cash flows, meaning every dollar collected during the fiscal year. That's not the number on the cash flow statement titled "cash flow from operating activities." For Ciesielski, two factors distort that figure, making it an unreliable measure of true performance. First, official cash flow is calculated after cash income taxes, so that falling taxes can create the illusion of ongoing progress. Second, interest is also subtracted, and the size of the annual interest levy reflects the level of leverage, but has nothing to do with how well management is managing their assets.

Hence, Ciesielski advocates adding back cash taxes and cash interest to calculate pure operating cash flows. That's the numerator.

The denominator consists of every dollar spent on the assets that produce those operating cash flows. To calculate that figure, take "total assets" from the balance sheet, and add "accumulated depreciation" to account for the plants or fabs still making cars or semiconductors that, for accounting purposes, are fully expensed. Fortunately, cash taxes, cash interest, and accumulated depreciation must be reported each year in the 10K, and loads of new information is just now being filed. For large companies, the deadline for 10K filings was March 4. So that investors can perform extremely up-to-date analysis.

The paramount metric is COROA, the operating cash flow as a percentage of total assets. For Ciesielski, that's the best measure of pure profitability. If the number has been high for a while, and is either staying high or improving, evidence is strong that the company is generating strong returns from its new investments. That's the quality that Buffett looks for.