CASHING IN: Mike Markowski (standing) and his brother David believe that investors should stop worrying about a company's earnings per share and instead focus on its operating cash.

How to Spot an Enron

Two brothers predict that cash flow will eclipse earnings as the ultimate metric for sizing up a company's health

CEOS LIE. Analysts lie. Company insiders lie. That much we have learned in the past year. Going forward, it seems likely that the market for financial information will change. But how? In 10 years what will investors look for in their portfolio companies? David and Mike Markowski think the answer is operational cash flow per share, or what they call "OPS." Their Web site, StockDiagnostics.com, follows that number—and more than 1,500 data points—for every publicly traded company in the United States. The company charges a $79 monthly fee for a premium subscriber service for investors who want to know when a company's cash flow fluctuates. Ultimately, Mike says, his company will provide an affordable "Bloomberg for the masses."

As a barometer of a company's health, OPS is more reliable than earnings per share (EPS), which can be too easily massaged, the brothers contend. A company either has cash or it doesn't. And, as Dartmouth business professor Rajesh Aggarwal notes, operational cash flow "does make adjustments for things like depreciation and amortization, and it takes into account changes in working capital."

Beyond watching the ratio, the StockDiagnostics software tool screens financial statements for a particular anomaly: negative OPS despite a company's reporting of "record" positive earnings. The phenomenon, which Mike Markowski calls "the EPS syndrome," often is the "first indicator that a company may be in trouble," David says. After the Enron collapse, Mike mined his database of company stats looking for signs that might have foretold the energy giant's downfall. He found that in August 2001, when Enron was reporting record earnings and its stock was trading at $35 to $47 a share, its cash flow was negative. "We double-checked [the idea] against Enron-type companies like Sunbeam, and they had the same anomalies," Mike says.

To be sure, OPS isn't the only number investors should watch. Joe Knight, co-owner of Setpoint Inc. and a frequent speaker on financial literacy, recommends scrutinizing balance-sheet ratios, including total-asset turnover, inventory turnover, and accounts-receivable days outstanding. "When a company manipulates its income statement, they have to throw things onto the balance sheet to hide them," he explains. Still, the Markowskis are banking on the public's dissatisfaction with the equity market and its analysts to drive interest in their product. "There's a huge demand from the public for anything that will give them objective information," says Mike. "People don't want to read an opinion. They want to look at statistics." And if he's right, they'll be willing to pay for them.

Kate O'Sullivan

Photograph by Randy Harris