Gearing

How debt amplifies both returns and losses.

Accounting & Finance

Gearing raises the volatility of returns to equity in both directions.

Gearing = Debt ÷ (Debt + Equity) · Interest cover = PBIT ÷ Interest

Profit rises 10% Interest is fixed.	**Equity return rises more**
Profit falls 10% Same mechanism.	**Equity return falls more**
Interest cover below 2	**Usually a concern**

THE COMMON MISTAKE

× **Reading high gearing as bad in itself**

✓ **It depends on cash flow stability**

A utility with predictable cash flows safely carries gearing that would endanger a cyclical manufacturer.

Operating gearing does the same thing with fixed costs. High fixed costs and high debt together is a fragile combination.