

Will Your Company be Bankrupt by next year?

You may not know Edward Altman, but he knows whether your company will be bankrupt in the next two years. Altman developed a deceptively simple formula that calculates the financial strength of a business and accurately predicts the probability of bankruptcy more than 90% of the time. The formula, called [Altman's Z Score](#), needs just 8 numbers — and all of them can be found on your income statement or balance sheet.

Is your bankruptcy imminent? Take the Z Score Test and find out for sure.

[By the way, [Edward Altman](#) is a Professor of Finance at the famous Stern School of Business at New York University. He developed the Z Score formula in 1968, and it is still the best way to tell whether your company is on the brink of disaster. Though the formula was originally designed to assess public manufacturing companies, Altman has since designed variations that apply to **privately held** manufacturing companies (called the Z' Score") and non-manufacturing companies (or Z'' Score), which we will use here.]

How to Calculate Your Own [Z Score](#)

(1) Grab your financial statements and calculate the following 5 ratios. Its not as hard as it looks: there are only 8 numbers you need.

The Variables You Need to Know:

A= (Current Assets-Current Liabilities)/Total Assets

B=Retained Earnings/Total Assets

C=Earnings before Interest and Taxes/Total Assets

D=Book Value of Equity/ Total Liabilities

E=Sales/Total Assets

(2) Next, decide whether your company is a manufacturer or not. Easy, right? Altman has a different formula for manufacturers and non-manufacturers. Find the formula you need below.

The Z' Score for Manufacturers:

$$Z' = 0.717 A + 0.847 B + 3.107 C + 0.420 D + 0.998 E$$

What's your score? If Z' is:

- Greater than 2.9, consider yourself 'safe'
- Between 1.23 and 2.9 you're in the 'grey' zone and bankruptcy is neither certain nor out of the question
- Less than 1.23 and you're in trouble.

For Non-Manufacturing Companies:

$$Z''\text{-score} = 6.56A + 3.26B + 6.72C + 1.05D$$

What's your score? If Z'' is:

- Greater than 2.6, consider yourself 'safe'

- Between 1.1 and 2.6 you're in the 'grey' zone and bankruptcy is neither certain nor out of the question
- Less than 1.1 and you're in trouble.

Accuracy of Altman's Z Score

Although broadly accepted, the Altman Z score is most accurate for businesses selling consumer durables, import/export services, and commercial property owners. The model has mostly failed in financial companies.

For most businesses, a low Z score is an indicator of declining financial health. Of course, no formula is perfect or always correct, but Altman's Z Score has survived 45 years by being amazingly accurate. If you are scoring low on this scale, it's time to take a long hard look at your business. If you think you might need help, I hope you'll contact before bad turns to worse.

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