



# The Other Side of Value: The Gross Profitability Premium

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Profitability, measured by gross profits-to-assets, has roughly the same power as book-to-market predicting the cross-section of average returns. Profitable firms typically generate significantly higher returns than unprofitable firms, despite having significantly higher valuation ratios. Controlling for profitability tends to also dramatically increase the performance of value strategies, especially among the largest, most liquid stocks. These results are difficult to reconcile with popular explanations of the value premium, as profitable firms are generally less prone to distress, have longer cash flow durations, and have lower levels of operating leverage. Controlling for gross profitability explains most earnings related anomalies, and a wide range of seemingly unrelated profitable trading strategies.

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