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ROCE, ROIC, ROE, and ROA

Explained in Simple Terms

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1) ROCE

ROCE (Return on Capital Employed) is a financial ratio that measures the profitability and efficiency of a company's capital (money) investments.

In simple terms, ROCE tells you how much profit a company generates for each rupee of capital it has employed (invested).

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It considers both equity (shareholder's investment) and debt (borrowed funds) that a company uses to finance its operations.

$$ROCE = \frac{EBIT}{Capital\ Employed} \times 100$$

EBIT is Earnings Before Interest & Tax also known as operating profit

A higher ROCE indicates that a company is effectively utilizing its capital to generate profits.

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2) ROIC

ROIC (Return on Invested Capital) is a financial ratio that measures the return generated by a company's total invested capital, including both debt and equity.

In simple terms, ROCE tells you how much value (returns) a company creates for its shareholders and debt holders.

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ROIC is calculated by dividing NOPAT (Net Operating Profit After Taxes) by the invested capital, where invested capital is the sum of total debt and shareholders' equity.

$$\text{ROIC} = \frac{\text{NOPAT}}{(\text{Total Debt} + \text{Equity})} \times 100$$

ROIC is compared with the Weighted Average Cost of Capital (WACC) to understand if the company is creating value for its investors.

3) ROE

Return on Equity (ROE) is a ratio that measures the profitability of a company in relation to its shareholders' equity.

It shows how efficiently a company utilizes the funds invested by its shareholders to generate profits.

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ROE is calculated by dividing the net income of a company by its shareholders' equity and expressing the result as a percentage:

$$ROE = \frac{\text{Net Income}}{\text{Shareholder's Equity}} \times 100$$

A higher ROE generally suggests that the company is effectively utilizing the shareholders' funds to generate profits

4) ROA

ROA (Return on Assets) is a financial ratio that measures a company's profitability in relation to its total assets.

It indicates how efficiently a company utilizes its assets to generate profits.

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ROA is calculated by dividing the net income of a company by its average total assets

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}} \times 100$$

ROA is a useful metric for investors, analysts, and management as it provides insights into the profitability of a company's operations.

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