Twitter Thread by Techno Funda Investing

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Thread ■explaining #ROE & #ROCE and its use in #FundamentalAnalysis

(Must read for #FA learners)

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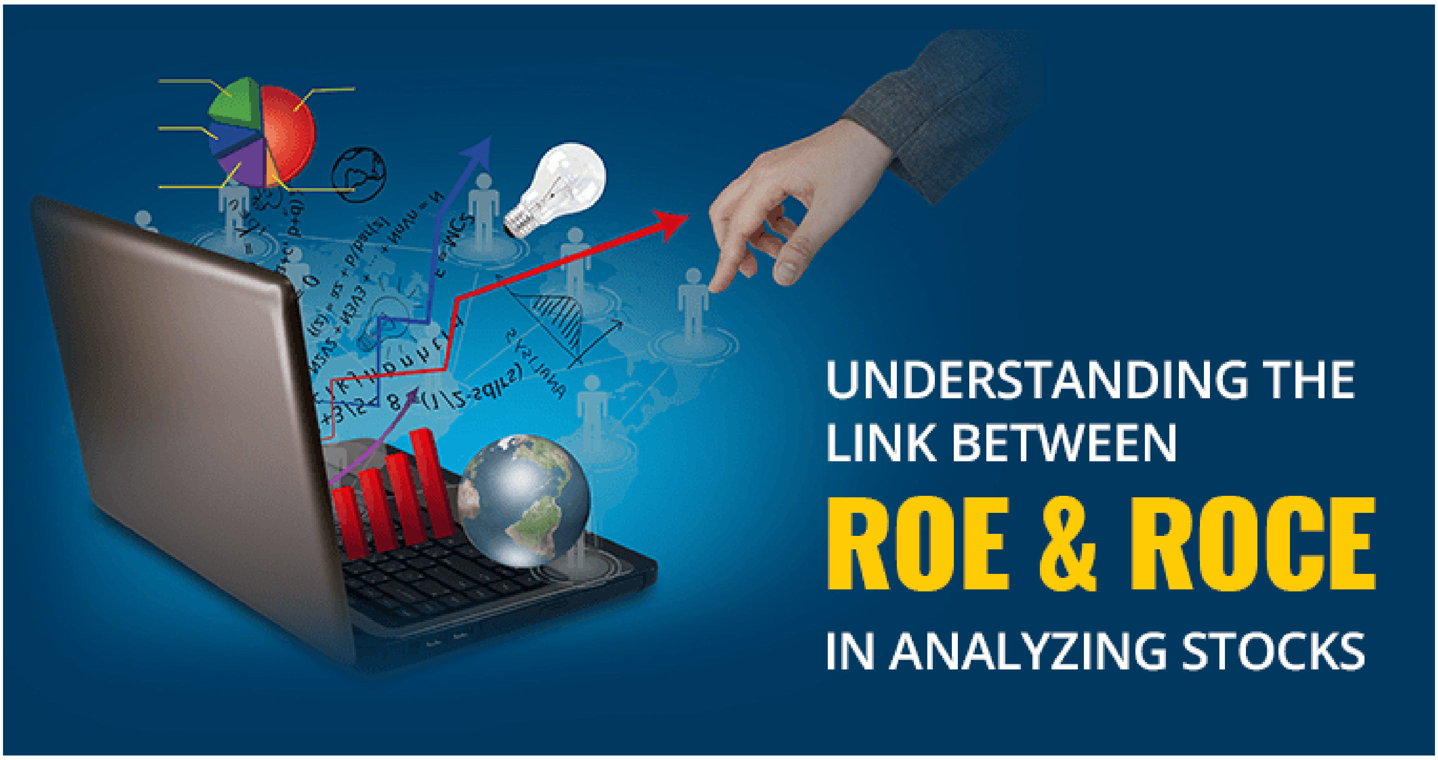
Views Welcome ■ @dmuthuk @Vivek_Investor @datta_arvind @caniravkaria @FI_InvestIndia @AdityaD_Shah

#FundamentalAnalysis #StockMarket



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Return on Equity (#ROE) and Return on Capital Employed (#ROCE) are two important Financial Ratios used in #FundamentalAnalysis of Stocks.

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Return on Equity (ROE) is the ratio of Net Income (Net Profit) of a company and it's Total Equity (Shareholder's Equity).

Here - Shareholders Equity = Share Capital + Reserves & Surplus.

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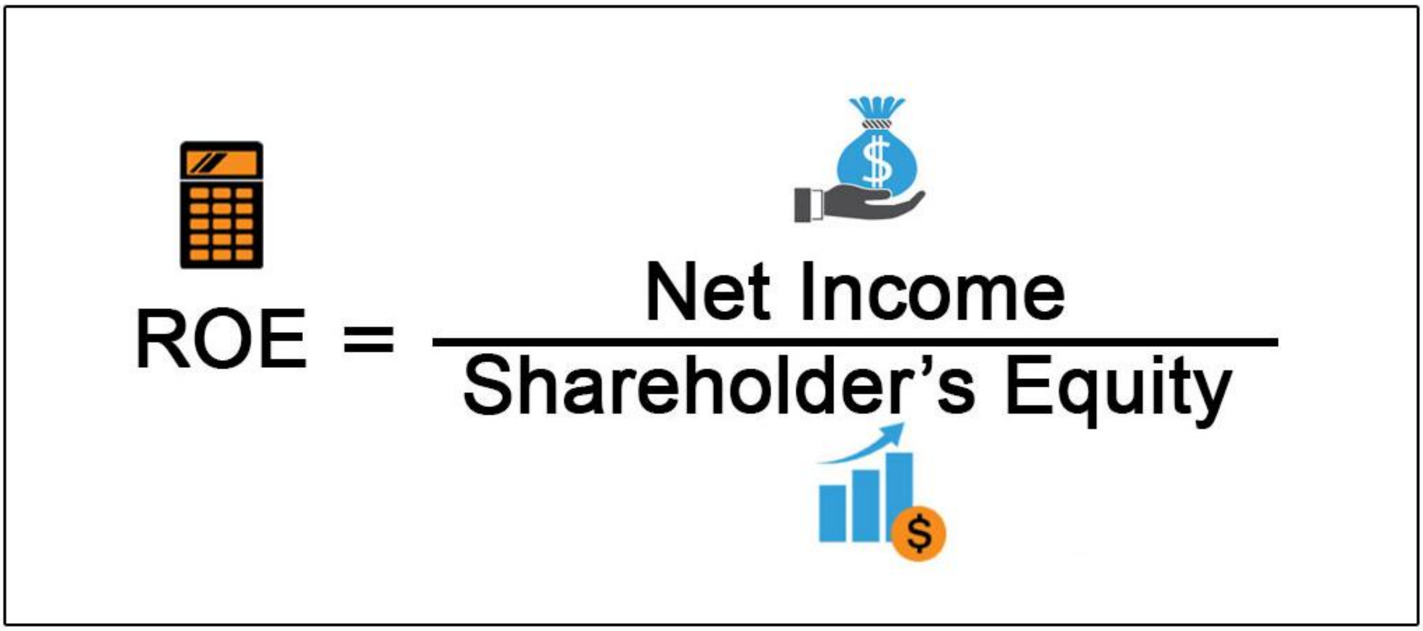

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#ROE is a measure of how much net profit a company is making for every rupee invested by its shareholders in the company.

It can be said that higher the ROE, better it is for the equity shareholders. It tells shareholders about how effectively their money is being used.

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However, you should not trust high ROE blindly. Biggest drawbacks or weaknesses of ROE is that it completely ignores debt.

Hence for companies having high levels of debt, ROE will give a higher but misleading value & therefore we need to look at #ROCE along with #ROE.

5■

Return on Capital Employed is ratio of company's Operating Profit i.e., Profit before Interest & Taxes (EBIT) and its Total

Capital Employed.

Here - Total Capital Employed = Shareholder's Equity + Short Term Debt + Long Term Debt

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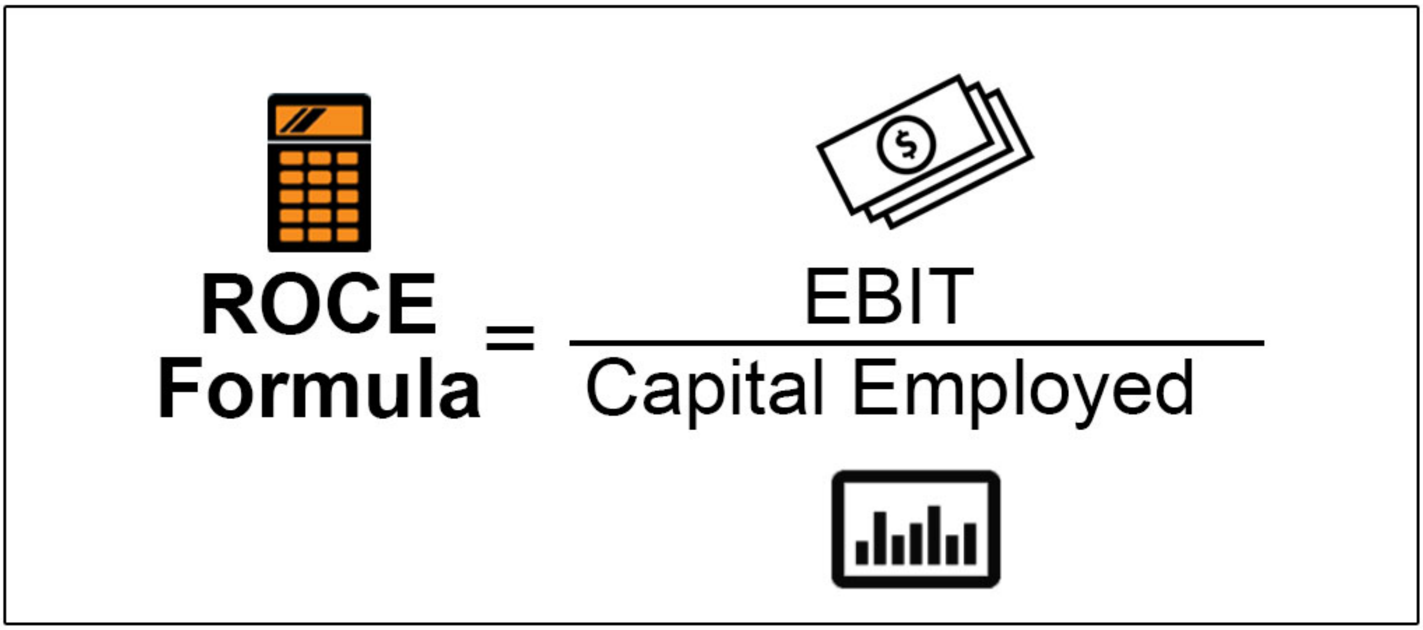

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Since #ROCE measures how much profit a company generates with its total capital employed, it overcomes a major weakness of ROE.

It can be said that higher the ROCE, the better it is. It means that business is profitable & company is utilizing its capital more economically.

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ROCE is a long term profitability ratio because it shows how effectively company's assets are performing while taking into consideration long term financing.

This is why ROCE is a more useful ratio than ROE to evaluate the longevity of a company.

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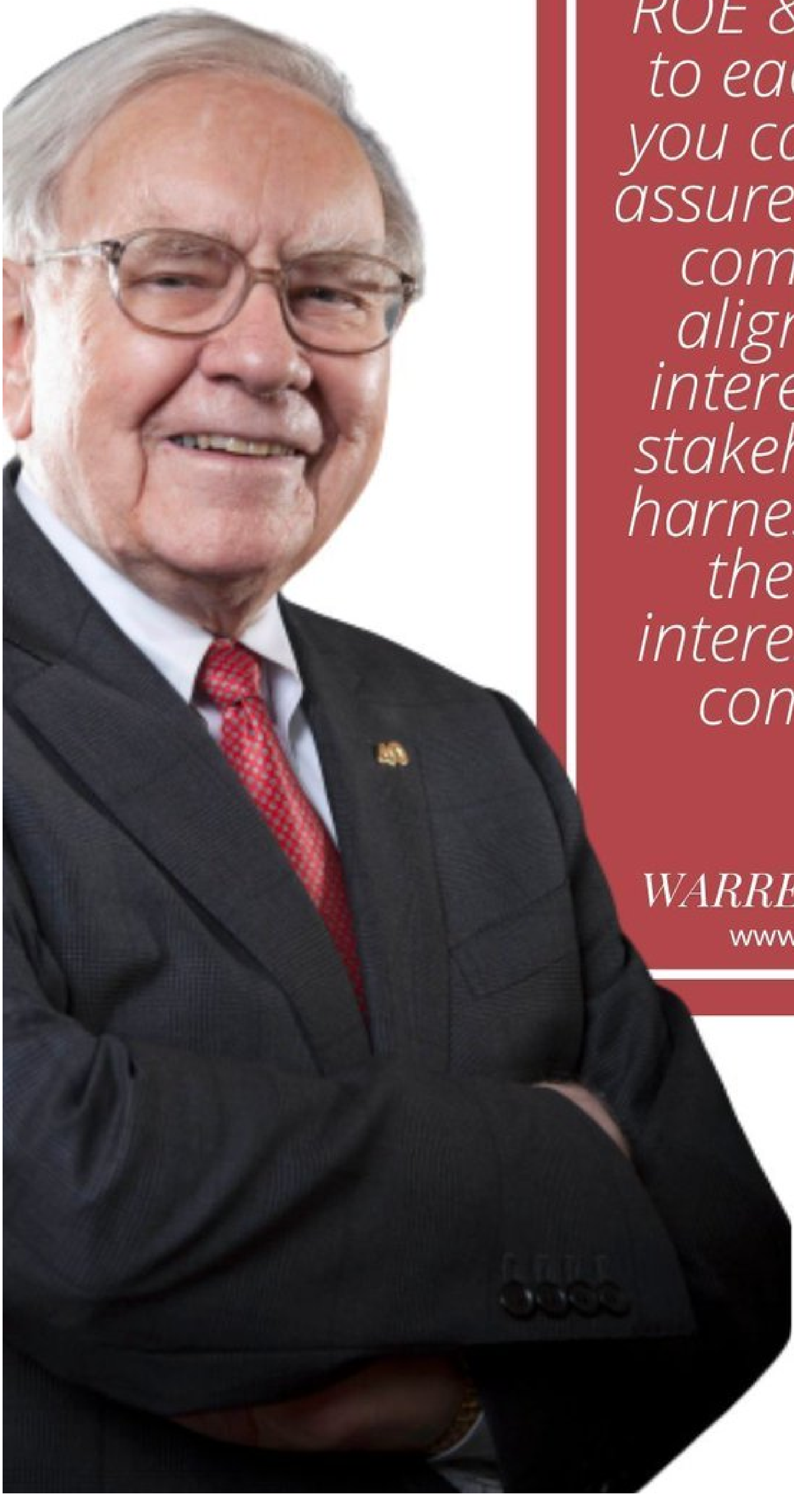
8■

@WarrenBuffett prefers to invest in companies which have both #ROE and #ROCE above 20%.

■He also prefers that value of ROE and ROCE should be close to each other.

■He avoids investing in companies where there is a large difference between ROE and ROCE.



"The closer the ROE & ROe are to each other, you can be rest assured that the company is aligning the interests of its stakeholders & harnessing it in the larger interests of the company"

WARREN BUFFETT

www.tradebrains.in

9■

Shall conclude this thread with a summary comparison table between #ROE & #ROCE

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ROE Vs ROCE

Basis For Comparison	Return on Equity (ROE)	Return on Capital Employed (ROCE)
Meaning	ROE measures how much profit a company generates with the money (capital) shareholders have invested.	ROCE measures how efficiently a company can generate profits from its capital employed by comparing operating profit to capital employed.
Formula	$ROE = \left(\frac{\text{Net Profit}}{\text{Shareholders' Equity}} \right)$	$ROCE = \left(\frac{\text{EBIT}}{\text{Total Capital Employed}} \right)$
Returns for	Equity Shareholders	Stakeholders (Equity + Debt)
Indicator of	Effective Management of Equity Financing to fund operations and grow company	Efficient Utilization of Total capital, Mirror image of Long-term Assets of the company