

CEO Lesson #8

How to assess returns

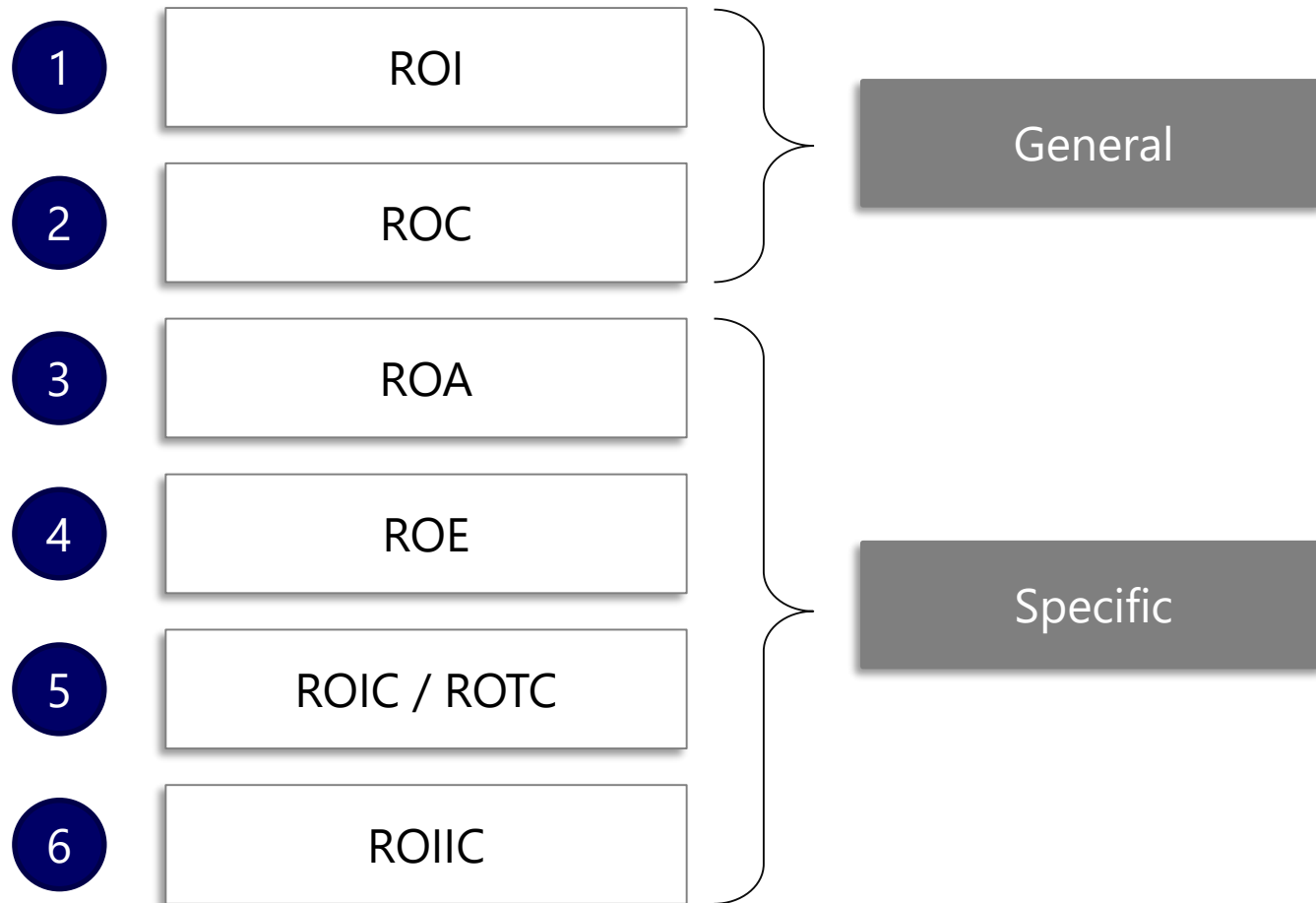
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“The value of a business is the value of its excess returns from new and existing investments” – Aswath Damodaran

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	<u>ROE</u>	<u>ROA</u>	<u>ROIC</u>	<u>ROTC</u>	<u>ROIIC</u>
<i>Formula</i>	$\frac{\text{Net Income}}{\text{Equity}}$	$\frac{\text{Net Income}}{\text{Assets}}$	$\frac{\text{NOPAT}}{\text{Invested Capital}}$	$\frac{\text{NOPAT}}{\text{Tangible Capital}}$	$\frac{\text{Cum. 5yr NOPAT}}{\text{Incremental Capital}}$
<i>Use case</i>	Quick / easy	Cap. neutral	Majority of cases	Hard assets	Change in model
<i>Drawbacks</i>	Share buybacks Debt vs Equity	Off balance sheet assets Lack of asset capex	Skewed for rapidly growing businesses	Negates intangibles that generate returns	Less well established Arbitrary increments

“Maximizing return on capital should not take precedence to maximizing economic profit, a measure that considers both the return on capital and the magnitude of investment.” – Michael Mauboussin

- [Credit Suisse - Calculating Return on Invested Capital](#)
- [Base Hit Investing – Calculating Return on Incremental Invested Capital](#)