CONCEPT: RATIOS – RETURN ON EQUITY (ROE)

● The ***Return on Equity (ROE)*** measures the income a company earns based on the amount of stockholders' equity

□ ROE is a common _______________ ratio

□ Investors want to maximize their returns!

$$Return\ on\ Equity\ (ROE) = \frac{Net\ Income}{Average\ Common\ Equity} = \frac{Net\ Income}{(BB\ Equity + EB\ Equity) \div 2}$$

Note: An average balance is used in many ratios. It is always calculated as ___________________
If you are only given one balance (i.e. ending balance), just use that number (no average!)

Note (2): This ratio is generally shown as a _____________, make sure to multiply by 100!

Analysis: The ROE tells how much net income the company earns for each dollar of common equity.

Comparison: A company's ROE depends on the break-up of its financing between debt and equity.
Highly leveraged companies (lots of debt) are riskier, but can earn bigger returns for their stockholders.

Red Flag: A negative ROE occurs if the company had a net ________

PRACTICE: XYZ Company had net sales during the period of $380,000 and net income of $60,000. If total equity was $480,000 at the beginning of the period and $720,000 at the end of the period, what is the company's ROE?

a) 8%
b) 10%
c) 13%
d) 63%

PRACTICE: A company has income before taxes of $100,000. Net sales are $400,000 and gross profit is $300,000. What is the ROE, assuming the company has a 40% tax rate, and average common equity was $900,000?

a) 6.7%
b) 11.1%
c) 33.3%
d) 44.4%