CONCEPT: RATIOS – RETURN ON ASSETS (ROA) = PROFIT MARGIN x ASSET TURNOVER

● The ***Return on Assets (ROA)*** measures the income a company earns based on the amount of assets it maintains

□ ROA is a common ______________ ratio

□ We can break up the ROA using two other ratios; this gives us more information about how ROA was derived

$$Return\ on\ Assets\ (ROA) = \frac{Net\ Income}{Average\ Total\ Assets}$$

or

$$ROA = Profit\ Margin * Total\ Asset\ Turnover = \frac{Net\ Income}{Net\ Sales} * \frac{Net\ Sales}{Average\ Total\ Assets}$$

Analysis: Profit Margin tells us how much net income we earn for each dollar of sales.
Total Asset Turnover tells us how many dollars of sales we earn per dollar of total assets owned.
A company can increase its ROA by (1) increasing profit margin and (2) increasing total asset turnover

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

PRACTICE: XYZ Company had a profit margin of 8.8% and total asset turnover of 0.77. What is XYZ's Return on Assets?

a) 6.78%
b) 0.07%
c) 11.43%
d) 9.57%

PRACTICE: A company had a profit margin of 6.1%. The company's net sales were $3,600,000 and Cost of Goods Sold was $600,000. If total assets were $3,450,000 at the beginning of the year and $4,210,000 at the end of the year, what is the company's return on assets?

a) 4.8%
b) 5.2%
c) 5.7%
d) Not enough information