

ROE vs. ROCE vs. ROIC

The Capital Efficiency & Value Creation Report

Which Metric Actually Matters? A Forensic Analysis.

Inter

Disclaimer: This report is prepared strictly for educational purposes. It does not constitute investment advice. Investors must conduct independent due diligence.



The Growth Trap vs. The Efficiency Truth

What Novice Investors Celebrate

- ✓ Revenue Growth
(Is the company getting bigger?)
- ✓ Profit Growth
(Is the bottom line expanding?)
- ✓ Market Share
(Are they beating competitors?)

What Professional Capital Allocators Ask

How efficiently is the capital being used to generate that growth?

Key Insight

Growth requires capital. If a company invests ₹100 to generate ₹5 of profit, it is growing but **destroying wealth. Long-term wealth = High Return on Capital + Ability to Reinvest.**



Level 1: Return on Equity (ROE)

The Shareholder's Perspective

$$\text{ROE} = \frac{\text{Net Profit (PAT)}}{\text{Shareholder Equity}}$$

It answers: For every rupee of shareholder money, how much profit did the company generate?

PRO TIP

NOTE: This metric is strictly for equity owners. It does not account for debt holders.



Case Study: Yashhtej Industries (Pre-IPO)

The Allure of the 83% Return

PAT (FY25):

₹11.57 Cr

Net Worth (Pre-IPO):

₹19.62 Cr

83.61% ROE

An ROE of 83% looks extraordinary. Most investors would blindly buy this. But a forensic look reveals a distortion.



The Leverage Trap

Financial Leverage acts as a steroid for ROE. It inflates returns in good times but threatens survival in bad times.



FinReason Insight Box

High ROE does not automatically mean a strong business. It often means high financial leverage. Risk disguised as Efficiency. If Equity is low and Debt is high, the return is inflated.



Level 2: Return on Capital Employed (ROCE)

The Business Perspective

$$\text{ROCE} = \frac{\text{EBIT}}{\text{Total Capital Employed}}$$

Total Capital Employed (Equity + Debt)

Total Capital Invested

This metric ignores WHO provided the money (shareholders or lenders) and focuses on the TOTAL capital invested in the business.

Best Use Case: Capital-intensive sectors like Manufacturing, Infrastructure, and Power.

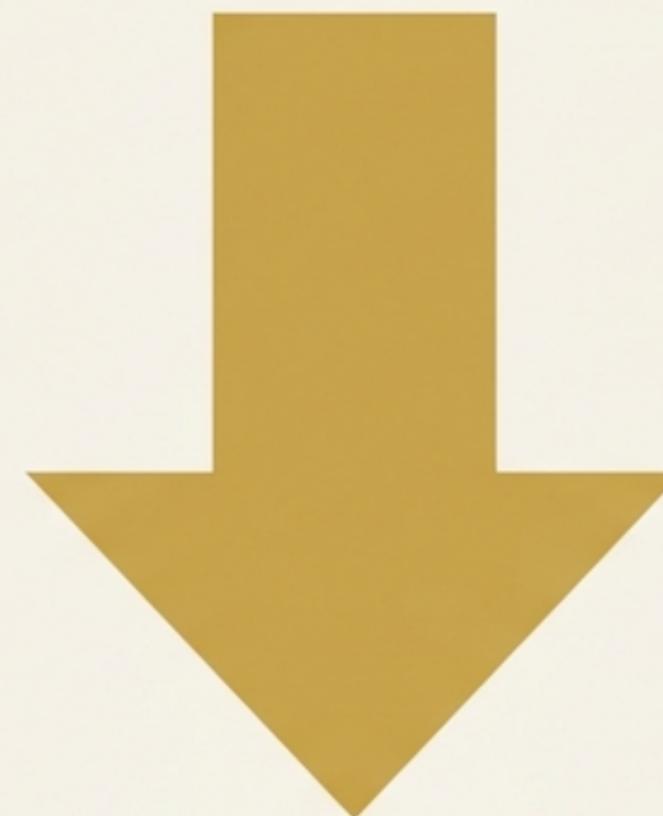
Case Study Revisited: The ROCE Reality Check

Old Denominator (Equity only): ₹19.62 Cr

New Denominator (Total Capital):
Equity (₹19.62 Cr) + Debt (₹43.85 Cr) ≈ ₹63.47 Cr

EBIT (Approx): ~₹21.02 Cr

83% ROE



Significantly Lower ROCE

The business operations are strong, but not 'magical.' The high ROE was driven by debt, while ROCE reveals the true operational ceiling.



Level 3: Return on Invested Capital (ROIC)

The 'True' Economic Measure

Gold Standard

$$\text{ROIC} = \frac{\text{NOPAT}}{\text{Invested Capital}}$$

NOPAT: Net Operating Profit After Tax

Invested Capital: Operating Assets - Non-Interest Bearing Liabilities

Why It's Superior

- Removes 'Excess Cash' noise.
- Removes one-time financial structuring.
- Removes tax benefits from debt.
- Focuses purely on Operating Efficiency.

The Value Creation Test

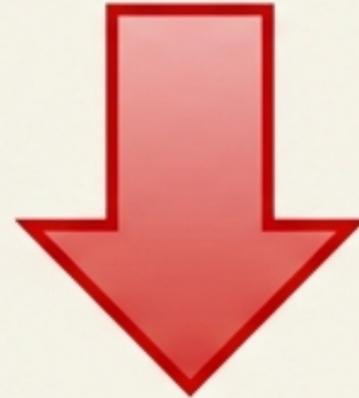
ROIC > Cost of Capital



**Wealth Creator
(Compounder)**

Cost of Capital (WACC)

ROIC < Cost of Capital



Wealth Destroyer

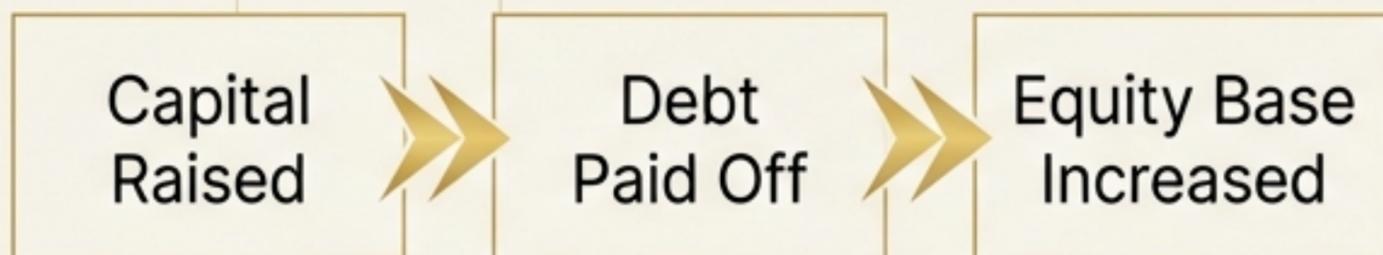
FinReason Insight Box

Growth without returns above the cost of capital is just value destruction. If ROIC is higher than the Cost of Capital, only then is the company truly creating wealth.



Post-IPO Reality: The Transformation

The Shift



Debt/Equity Ratio: **~0.40**

ROE Normalized: **~10-12%**

The Analysis

Novice View

“Oh no! **ROE dropped** from 83% to 12%!”

Professional View

“The business has **de-risked**. The 83% was unsustainable leverage. The 12% is the **real, safe** return on equity.”

FinReason Insight Box

Pre-IPO ROE is often a mirage. Always evaluate Post-Dilution numbers.



The Forensic Summary: Yashtej Comparison

Metric	Pre-IPO	Post-IPO	Interpretation
ROE	~83%	~10-12%	Earlier figure distorted by high leverage.
Debt/Equity	2.23	0.40	Financial Risk Reduced.
Capital Structure	Debt-Heavy	Balanced	Stability Improved.

The shift from 'Debt-Heavy' to 'Balanced' creates sustainability at the cost of artificially high optical returns.



The Selector: Which Metric, When?

ROE

- Banks, NBFCs, IT Services

Use for **asset-light** or leverage-driven businesses where **equity is key**.

ROCE

- Manufacturing, Infrastructure, Power

Use for sectors with **heavy debt**. Captures the return on **ALL capital**.

ROIC

- Retail, FMCG, Pharma

Best for calculating **Intrinsic Value** and assessing **competitive advantage (Moat)**.



The Real Wealth Formula

$$\text{Wealth} = \text{Invested Capital} \times (\text{ROIC})^n$$

High ROIC
(e.g., > 20%)

Reinvestment Opportunity
(Put money back in at the same rate)

If a company has High ROIC but cannot reinvest (pays it all out as dividends), growth slows. Compounding is not magic; it is math.



The Business Owner's Checklist

Before investing, ask these four questions:

- ☑ Is the **high ROE** driven by profit efficiency or just **high debt**?
- ☑ Is **ROCE** stable over a 5-year period?
- ☑ Is **ROIC** clearly above the **Cost of Capital** (typically **>12-15%** in India)?
- ☑ Can the company **reinvest its profits at high rates**?

Traders chase EPS Growth. Business Owners Owinest study Capital Efficiency.



Conclusion

ROE can impress headlines.

ROCE clarifies operations.

ROIC reveals economic truth.

**In long-term investing: Capital
Efficiency Determines Destiny.**