



MERCER CAPITAL

Why ROIC Matters for Family Business Directors

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BUSINESS VALUATION &
FINANCIAL ADVISORY SERVICES
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ROIC Helps Tell the Rest of the Story...

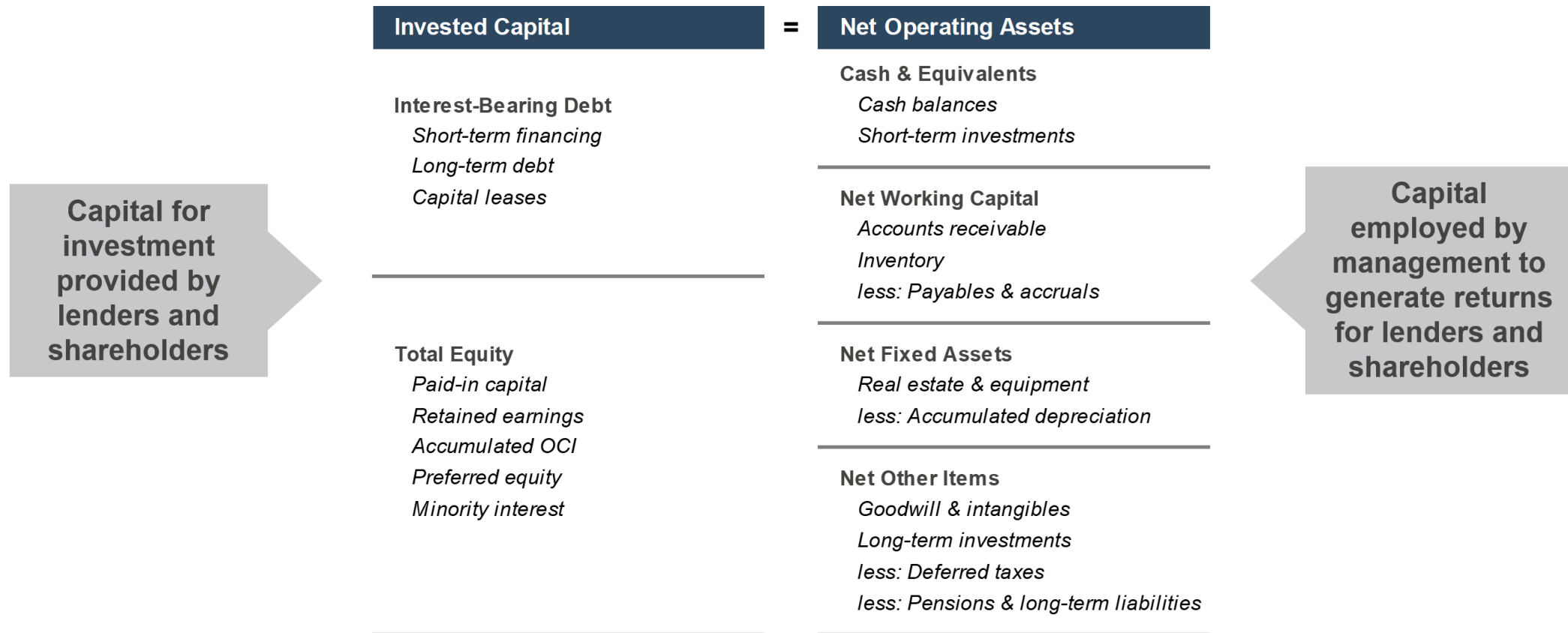
**Capital provided
for operations by
shareholders and
lenders**



**Earnings generated
using capital from
shareholders and
lenders**

Keeping Capital Busy

Every dollar of family capital should have a job to do



Re-thinking Profitability

ROIC focuses on operating profit rather than net income

Net Operating Profit After Tax

Revenue

less: Cost of Goods Sold

Gross Profit

less: Cash Operating Expenses

less: Depreciation & Amortization

Earnings Before Interest & Taxes

less: Pro Forma Taxes

Net Operating Profit After Tax

Excludes
interest expense
to make ROIC
independent of
capital structure

Taxes calculated
as-if EBIT were
taxable

Building a Performance Scorecard

The essence of capital budgeting is calculating expected returns on projects relative to the cost of capital

$$\frac{NOPAT}{Avg\ Invested\ Capital} = \frac{Revenue}{Avg\ Invested\ Capital} \times \frac{NOPAT}{Revenue}$$

Capital Efficiency **Profitability**

Capital Efficiency



Liquidity Drag



Cash Conversion Cycle



Fixed Asset Turnover



M&A Reliance

Profitability



Gross Margin



Operating Efficiency Ratio










Effective Tax Rate

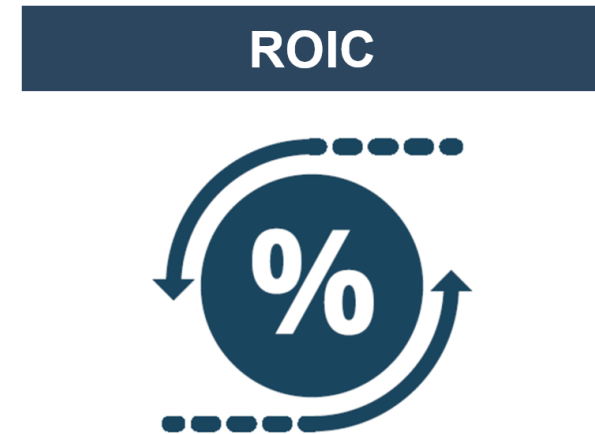
Illustration

Using ROIC as a performance management tool

$$1.9x \times 3.9\% = 7.4\%$$

Capital Efficiency	
	5.6%
	11 days
	2.8x
	9.3%

Profitability	
	19.0%
	13.8%
	25.0%



Does it Really Matter?

Results of a study of public company results

- 1 – High ROIC companies grow faster.** ROIC-focused companies make sure the assets they own are generating revenue.
- 2 – High ROIC companies distribute more cash to shareholders.** Companies that pay attention to ROIC get “lazy” capital off the balance sheet and into the hands of shareholders.
- 3 – High ROIC companies are less risky.** ROIC-focused companies have less volatile earnings and pay off debt more quickly than other companies.
- 4 – High ROIC companies provide better returns to shareholders.** ROIC is a powerful predictor of future shareholder returns.
- 5 – High ROIC companies are worth more.** Relative to book value, investors pay a premium for companies delivering high ROIC.



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Travis W. Harms leads Mercer Capital's Family Business Advisory Services Group. Travis's practice focuses on providing financial education, valuation, and other strategic financial consulting to multi-generation family businesses. The Family Business Advisory Services Group helps family shareholders, boards, and management teams align their perspectives on the financial realities, needs, and opportunities of the business. Additionally, Travis is a regular contributor to Mercer Capital's blog, *Family Business Director*.

[>> Click here to learn more about Travis](#)

Mercer Capital's Family Business Advisory Services

Mercer Capital provides financial education services and other strategic financial consulting to family businesses.

Services

- Customized Board Advisory Services
- Management Consulting
- Independent Valuation Opinions
- Transaction Advisory Services
- Confidential Shareholder Surveys
- Benchmarking / Business Intelligence
- Shareholder Engagement
- Shareholder Communication Support

We help family ownership groups, boards, and management teams align their perspectives on the financial realities, needs, and opportunities of the business.

We also help family business boards and management teams explain strategic financial decisions to shareholders and help shareholders communicate preferences to boards and management teams.

We have had the privilege of working with successful family and closely held businesses for the past 35 years. Given our experience, we are convinced that an engaged and informed shareholder base is essential for the long-term health and success of a family or closely held business. Yet, cultivating an engaged and informed shareholder base is often difficult. We can help.

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