CHAPTER 1 Value Creation, Financial Statements, and the Environment of Financial Reporting

CASE AND REVIEW QUESTIONS (p 26-27)

1.

	Return on Equity		
	Home Depot	Kingfisher PLC	Lowe's
Beginning Equity	26,909	4,320	14,296
Ending Equity	25,030	4,421	15,725
Average Equity	25,970	4,371	15,011
Net Income	5,761	338.4	3,105
Return on Equity	22.2%	7.7%	20.7%

2. Net income is an incomplete measure of value creation because it ignores the cost of capital. Cash flow is not a measure of value creation because it only measures the increase in the amount of cash and ignores all other indicators of value.

	Return on Equity		
	Home Depot	Kingfisher PLC	Lowe's
	amounts in millions		
Return on Equity	22.2%	7.7%	20.7%
Cost of Equity Capital	12.0%	12.0%	12.0%
Net Return on Equity	10.2%	-4.3%	8.7%
Average Equity	25,970	4,371	15,011
Value Created (Destroyed)	$ 2,645	(186.1)	$ 1,304
Pounds to Dollars		$ (94.9)	

Speculating as to why the returns differ, it appears that Kingfisher's selling and administrative expenses are much higher as a percentage of gross sales than those of Home Depot. This could be attributable to any number of causes, from management competence, to employee compensation levels, to general business environment considerations.

	Home Depot	Kingfisher PLC
Revenue	90,837.0	8,675.9
Selling and administrative expenses	20,110.0	2,641.0
S and A as % of revenue	22.1%	30.4%