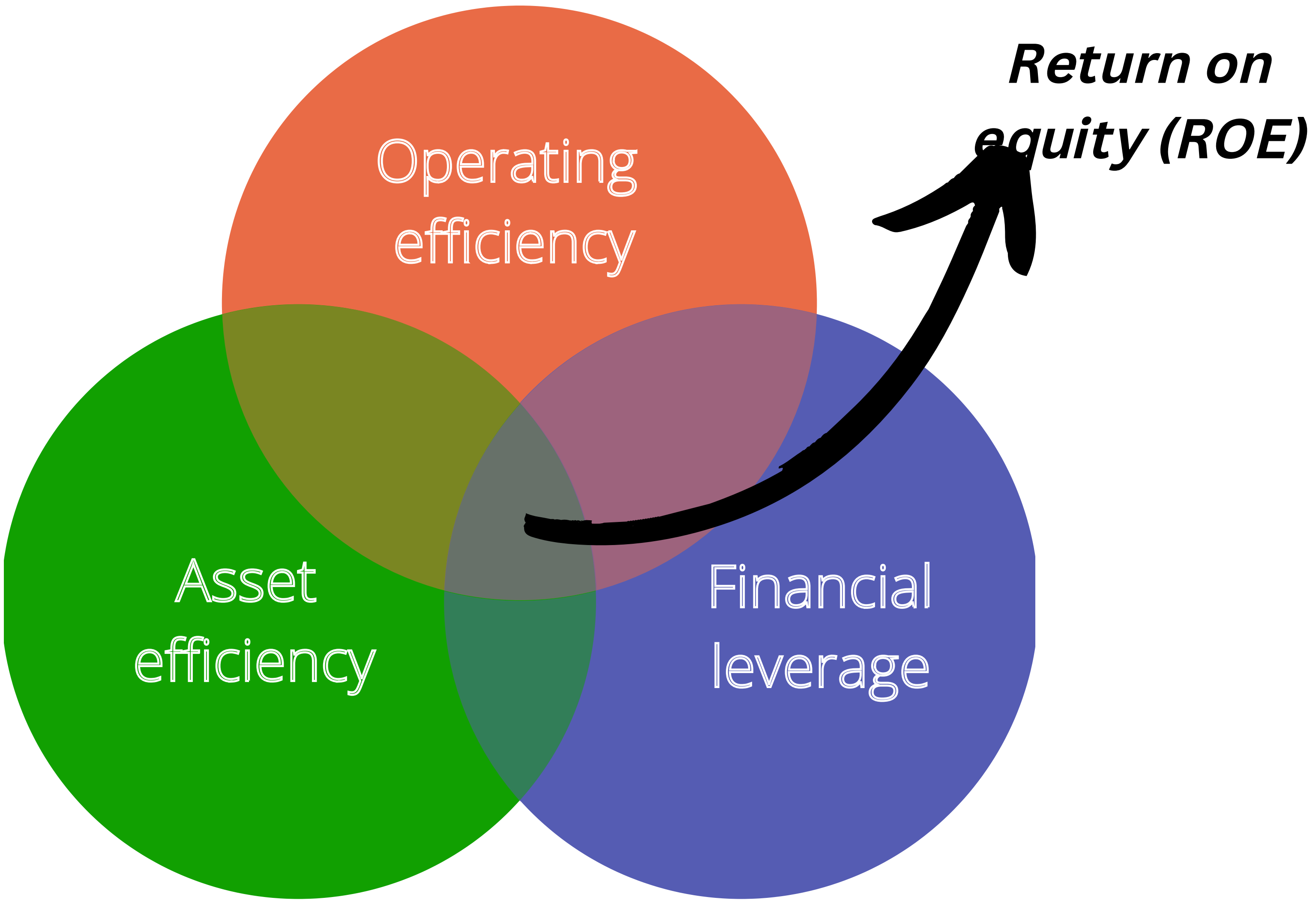
FINANCE 101

DUPONT ANALYSIS

BREAKING DOWN THE COMPONENTS OF RETURN ON EQUITY

INTRODUCTION

Dupont analysis refers to breaking down the components of return on equity and studying them individually to gain a deeper insight to understand company's weak areas.



DIVING DEEPER

- ***Net profit margin (Net Income/Total Sales):*** It is the profit obtained after deducting all expenses and charges. The net profit, after taxes, is distributed among shareholders. *ROE increases with higher net profit margin*

- ***Asset turnover ratio (Total Sales/Assets):*** It is the efficiency of an asset. It reflects the revenue generated by an asset. Therefore, *ROE increases with efficient utilisation of assets*

- ***Financial leverage (Total Assets/Equity) :*** It is the amount of debt held by the company. Financial leverage is a charge against profit, hence tax deductible. Therefore, *ROE increases with enhanced financial leverage*

ROE = Net Profit Margin * Asset Turnover * Leverage

CASE STUDY

	Walmart	TARGET
Profit margin	*3.36%*	*2.72%*
Net profit	*16,022,000*	*1,971,000*
Total sales	*476,294,000*	*72,596,000*
Asset turnover	*2.33*	*1.63*
Total assets	*204,751,000*	*44,553,000*
Leverage	*2.69*	*2.74*
Total equity	*76,255,000*	*16,231,000*
ROE	*21.01%*	*12.14%*

ANALYSIS & CONCLUSION

Let us examine the above example step-by-step -

- Walmart has a *higher operational efficiency*

- Both companies show high turnovers, and low net profit %

- Walmart indicates better asset utilisation (check Asset turnover numbers) since the company reaped *$2.33 for every dollar invested in the asset.* On the other hand, Target reaped only *$1.63 per dollar*

- Dupont analysis presents a higher return on equity in case of Walmart, since *Walmart was able to utilise its assets in a relatively more effective manner, despite having similar profit % and lower financial leverage than Target*

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