DuPont Analysis & ROE Decomposition Master Cheat Sheet

3-Step vs. 5-Step DuPont Frameworks, Profitability Levers & Financial Diagnostics

1. THE 3-STEP DUPONT FRAMEWORK

DuPont Component	Calculation Formula	Operational Meaning & Management Diagnostic
1. Net Profit Margin	Net Income / Net Sales	**Operating Efficiency:** How much profit is extracted from each dollar of revenue after all expenses.
2. Asset Turnover	Net Sales / Average Total Assets	**Asset Efficiency:** How effectively the company deploys assets to generate sales volume.
3. Equity Multiplier	Average Total Assets / Average Equity	**Financial Leverage:** Reliance on debt vs. equity financing. (Assets / Equity = 1 + Debt/Equity).
Return on Equity (ROE)	**Net Margin × Asset Turnover × Equity Multiplier**	Shows whether high ROE stems from high margins, efficient turnover, or risky debt leverage.

2. THE 5-STEP EXTENDED DUPONT MODEL

Ratio	Formula	Core Driver Isolated
1. Tax Burden	Net Income / EBT	Portion of pre-tax profit kept after corporate taxes.
2. Interest Burden	EBT / EBIT	Cost of debt service (1.0 = zero debt/interest).
3. Operating Margin	EBIT / Net Sales	Core operating profitability before interest & taxes.
4. Asset Turnover	Net Sales / Avg Assets	Revenue generation efficiency per asset dollar.
5. Leverage Ratio	Avg Assets / Avg Equity	Degree of balance sheet leverage.

3. DIAGNOSTIC SCENARIOS: HOW TO INTERPRET ROE

- **High Margin + Low Turnover:** Luxury goods, proprietary software, premium pharmaceuticals.
- **Low Margin + High Turnover:** Grocery chains, discount retail, commodity distributors.
- **High ROE Driven Exclusively by High Multiplier:** Warning signal of excessive debt risk and potential insolvency.

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