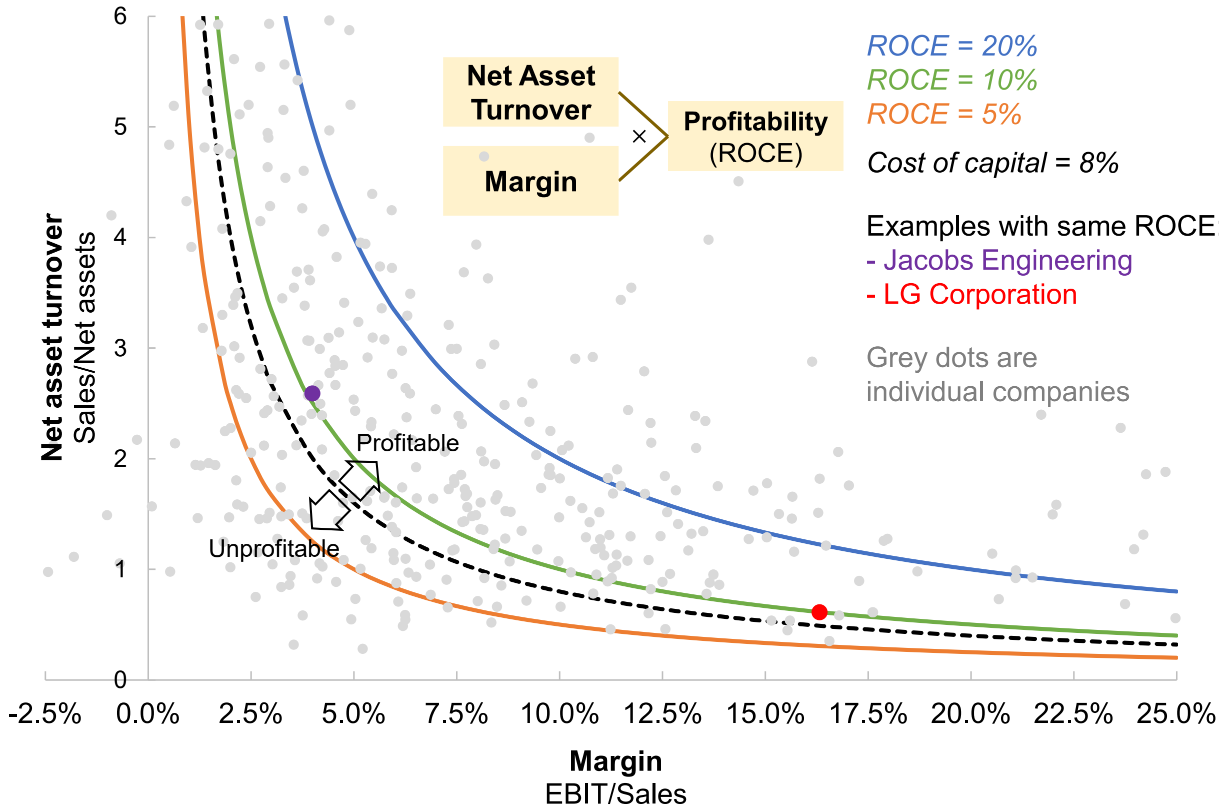
TELLUSANT QUICK READS

INTRODUCING DUPONT CURVES

DuPont analysis is one of the most fundamental concepts in financial theory. Here is a new take using what we call DuPont curves.

PROFITABILITY (ROCE) ALONG DUPONT CURVES



❶ Profitability is determined by return on capital employed (ROCE), which is the product of margin and asset turnover.[1]

❷ The colored lines show equal ROCE for various margin and asset turnover combinations

❸ If ROCE > cost of capital (WACC) then the company is profitable. The dotted grey line shows approximate average WACC = 8%

❹ Grey dots show 400 companies globally with revenue >$10B. 70% of them are profitable (ROCE>WACC).

❺ Look at the two highlighted companies. They are dissimilar in the composition of ROCE. Jacobs is a construction services company. LG is in electronics. Yet they have the same

ROCE and should be viewed as equally attractive from a current profitability perspective.

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The conclusion is that there are many ways to be profitable. This is sometimes puzzling to people.

Executives in high margin businesses may think that, e.g., retail is a bad business because margins are low (around 5%). However, retailers have superior asset turnover.

Those retailers may think high margin businesses are bad because they tie up a lot of capital. Yet, on balance they can be equally profitable.

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[1] This is the capital employed view (sometimes called ROIC). One can also take the equity view and express the formula in terms of return on equity (ROE).

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