Financial analysis

The current ratio indicates the firm's ability to pay its current liabilities with its current assets (Wood, 1994, p. 418). The current ratios of Johnson & Johnson are very high. It was 1. 7 from 2002 to 2003 and has risen gradually in recent years until it is 2. 5 in 2005. Such a high current ratio is not ideal as it may mean that the company has too much liquidity and is not optimizing its investment opportunities. The current ratios of Procter & Gamble range from 0. 8 to 1. 2. When the current ratio is 0. 8, the company may have difficulty in meeting its financial claims. The current ratios of Merck & Co are ideal, being generally slightly greater than 1. The quick ratio measures whether the firm has enough liquid resources to meet its current liabilities by excluding stock from the current assets in the current ratio (Wood, 1994, p. 418). In this regard, Johnson & Johnson is performing better than its competitors. Its quick ratios for the recent 4 years are slightly greater than 1 while those for its competitors are generally below 1.

The debt/equity ratio shows the proportion of long term debt to internal financing. The debt/equity ratios of Johnson & Johnson are at ideally low levels of between 0. 05 to 0. 11, which are lower than that of the industry average at 0. 23. The debt/equity ratios of Procter & Gamble are quite high, ranging from 0. 59 to 0. 81. However, they are lower than the industry average of 1. 01. The debt/equity ratios for Merck & Co., though not as good as those for Johnson & Johnson are reasonable at between 0. 27 and 0. 33. The leverage ratio shows the amount of assets that a dollar of equity finances. The leverage ratio of Johnson & Johnson at 1. 5 to 1. 8 are ideal being lower than the industry average of 2. 1 and also those of its competitors that range from around 2 to 3. The interest coverage from continuing operations shows the extent to which profit may fall before the

firm will not be able to meet its interest charges. When this happens the firm faces being taken over or being wound up. Again, the interest coverage from continuing operations for Johnson & Johnson is excellent. It shoots up from 59 in 2002 to an extremely ideal figure of 253. 8 in 2005, especially in light that the industry average is only 27. 4. The interest coverage from continuing operations for Procter & Gamble is not as good as that of Johnson & Johnson. It ranges from 12. 1 to 14. 4 and the data exhibits a downward trend. The interest coverage from continuing operations for Merck & Co also not as good as that of Johnson & Johnson. It decreases sharply from 2004 to 20. 1 and is below the industry average of 27. 2.

The asset turnover ratio calculates the total sales (revenue) for every dollar of assets a company owns (Kennon online). The asset turnover ratio for Johnson & Johnson at 0. 9 is comparable with that of Procter & Gamble. The asset turnover ratios of Merck & Co hovering around 0. 5 to 0. 6 in recent years are not as ideal as those of its competitors. The inventory turnover ratio shows the number of times the average stock was sold and replenished. The higher the better – it means the stock is sold at a faster rate. Compared to Merck & Co that has an inventory turnover ratio of greater than 1 in recent years, the inventory turnover ratio of Johnson & Johnson is acceptable at around 3 in recent years but not as good as that of Procter & Gamble that has an inventory ratio of greater than 5. The receivables turnover shows the number of times in a year the debts are collected. A higher figure would mean greater efficiency in debt collection. Again, Johnson & Johnson with a receivables turnover of around 7 fares better than Merck & Co with a receivables turnover of around 14 but worse than Procter & Gamble with a receivables turnover of 6 in this aspect. The receivables per day sales shows

how long the business took to collect its debts. Johnson & Johnson has room for improvement in this aspect. Its receivables per day sales has been decreasing from more than 50 to 49. 95 days in 2006. But it still cannot beat that of Procter & Gamble at around 25 to 30 days.

The profit margin shows how much profit was made out of every dollar of sales. As can be seen from the pre-tax profit margin, post-tax profit margin, and the net profit margin, Johnson & Johnson generally has a higher profit margin than Procter & Gamble but it could not rival Merck & Co. ROE shows the profit available to ordinary shareholders out of every dollar of their investment. Though ROE of competitors (33% to 45%) was better than that of Johnson & Johnson (26% to 29%) from 2002 to 2004, they have dropped in 2005 such that Johnson & Johnson is able to outperform its competitors at 27. 5%. The ROA shows how much profit was earned out of every dollar of total assets. Johnson & Johnson generally fares better than its competitors in ROA across all four years with a ROA of around 15% to 18%.

WORKS CITED

Kennon, Joshua. “ Asset Turnover.” About. 31 October 2006. About, Inc.

Wood, Frank. Business Accounting 1. London: Pitman Publishing, 1994.