

Financial performance analysis of amazon



Executive Summary

Amazon. com, Inc (Amazon) registered strong growth of 36% in 2008 mainly due to increased unit sales and expanded sales base in several categories. Meanwhile during the 3rd quarter of 2009, Amazon managed to report a steady growth despite the recession period. This report reviews and analyse Amazon financial performance as well as comparison with its competitors. All analysis and ratios are derived from data collected from respective companies' annual reports and [www. reuters. com](http://www.reuters.com).

Brief Description of the Company

Amazon is one of the leading online retailers in the world based in Seattle, Washington, United States of America. The company started its operation in 1995 and has regional involvement in the Asia Pacific, North America and Western Europe. Initially the core business of the company is selling online books however has diversified to products such as apparel, electronic and home improvement products.

The company is involved in the internet retailing industry with 7. 5% market share in 2008. The e-commerce industry has gone through major phases of growth and decline however, Amazon persevered and surprised everyone. Amazon achieved its first annual profit in 2003 and has continuously performed better each year.

Amazon's main competitors are the book retailer, Barnes and Nobles (BN) and third party retailing non-book related good, Ebay. com (Ebay). BN and Ebay are engaged in the similar industry as Amazon, which is online business and catalogue retailing of single and diversified product lines

In terms of market capitalisation, Amazon has the highest at \$59. 57 billion and followed by Ebay and BN at \$30. 59 billion and \$1. 21 billion respectively. This indicates that Amazon has greater stability and low risk compared to the competitors.

Financial Analysis

Profitability

The company's performance has improved wherein it has performed above the projections made throughout the four years period. Net sales have increased by 29. 2% from \$14, 835 million in 2007 to \$19, 166 million in 2008 with net income of \$476 million and \$645 million respectively. The Cost of Sales (COS) has increased throughout the years partly contributed from the free shipping cost and has affected the net income figure. There was a drop in the net income in 2006 due to increase spending on technology and content and in income tax expenses. However, the said figure has increased thereafter.

In terms of sales, Amazon has performed double from the competitors throughout the four-year period. Sales increased tremendously primarily due to low prices, vast selection of products and free shipping offers.

However, in terms of Gross Profit Margin (GPM), Ebay operated at 74% has outperformed Amazon at 23% in 2008. The reason behind this is due to Amazon's high expenditure on Cost of Sales (COS), which is about 70% of its sales value. The high COS was mainly contributed from the free shipping cost incurred. In comparison to Ebay, the company applies different business model from Amazon and have managed to minimise its expenditure on COS at about 20% of its sales value and therefore reflected to a high GPM. GPM <https://assignbuster.com/financial-performance-analysis-of-amazon/>

proves that eBay is generating a very large percent of net income from each dollar of sales and this contributes greatly to the growing of eBay's overall financial strength. Meanwhile, BN showed a better margin because of its smaller size and the retailer aspect.

Amazon and BN have a stable Operating Profit Margin (OPM) of 4% compared to Ebay, which fluctuates within the same period. Its constant operating expenses of 20% from its sales value support the stable growth for Amazon's OPM. Ebay's fluctuation figures are resulted from high expenses incurred from selling, general and administrative.

Based on the industry standard, Amazon and its competitors have performed ahead from the standard, which are 14.1% and 0.53% for GPM and OPM respectively. The low OPM standard can be ascribed to the effect of the recent financial crisis.

As of the 3rd quarter of 2009, Amazon's sales were \$14,989 million with net income of \$518 million. For the current year, it is projected a further increase of 21% and 19.5% in sales and COS respectively from 2008 primarily to the low prices, vast selection and free shipping offers. With the said sales projection, the net profit is projected at \$743 million in 2009. The basis for the projection takes into consideration on the global economic downturn and changes in customer purchasing preferences.

Based on the current quarter performance, the same trend was observed wherein Amazon is still having the highest net sales while Ebay still dominating the net income figure. BN was badly hit from the result of economic crisis.

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In comparison with the competitors, Amazon's Return on Equity (ROE) was high in 2005 at 135% but drastically dropped throughout the years to 40% and 20% in 2007 and 2008 respectively. The main reason for the decrease was due to the yearly increase in the business's equity. As at 2008, Amazon's ROE is equivalent to the competitors and is expected to be in line with the competitors in the future.

In comparison on the ROE and Return on Assets (ROA), Amazon has the highest growth among its competitors as it has a smaller capital base than Ebay and a higher profit level than BN. The high ROE indicates that Amazon is continuing to grow. Meanwhile the ROA showed that Amazon is efficient in generating income from its assets compared to its competitors. The industry standard for the ROE and ROA are 3.8% and 1.6% respectively. The lower industry standard might be driven by the economic condition, which has a great impact to the performance and profitability of most companies.

There was an increase of 1% for each year from 2006 to 2008 for the Return on Investment (ROI), whereas the Return on Capital Employed (ROCE) was at the highest in 2008 at 29%. These have indicated that Amazon is efficient at using its assets to generate earnings compared to the competitors.

Liquidity and leverage analysis

The company's current ratios are more or less similar to BN during the four-year period. The company's current ratio was between the ranges of 1.3 to 1.5 for the past four years. This indicates that Amazon is able to lay its hands on \$1.30-\$1.50 for every \$1.00 they owe.

In comparison between current and acid test ratio, acid test ratio is lower at average of 1.0 within the years. It will enable the company to cover its short-term liabilities adequately with its liquid assets. This is within some of the industry standards of 1:1, showing that the company will be able to cover its short-term liabilities adequately with its liquid assets.

In comparison with the industry, Ebay performed better than Amazon for both the current ratio and acid test ratio. Amazon fell below the standard in the initial years but almost meeting the standard in 2008 at 1.5:1. Although not performing better than the industry average, Amazon has good and stable ratios, which indicates that the company is able to cover its current liabilities.

Amazon's gearing ratio was high in 2005 at 86% and subsequently reduces within the years to 13% in 2008. Due to the operational efficiency, increased sales and improved liquidity, Amazon was able to reduce its debt and currently the business is funded with internal generated funds. Meanwhile, Ebay has no borrowings and BN has an average of 30% for the gearing ratio.

The high borrowing in 2005 has a huge impact on the debt-to-equity ratio, which was 6:0:1. However as the borrowings is paid, the debt equity ratio when down to 0.2:1 in 2008. This indicates that Amazon has 20 cent debt for every \$1 equity the company have. As for BN, its debt/equity ratio was at average of 0.5:1 during the four years. Therefore, in comparison, Amazon is less risky than BN. As Ebay has no borrowing, the interest cover for the said company is high compared to Amazon and Ebay.

In comparison with the debt-to-equity ratio set by the industry, Amazon has a very low ratio of 0.2 compared to 40.98. As mentioned earlier, the industry ratio is on the high side due to the economic condition.

Investment analysis

Amazon's common shares outstanding plus shares underlying stock-based awards outstanding totalled 446 million on December 31, 2008, compared with 435 million a year ago. As of to date, the said shares amounted to 451 million.

Based on Amazon's Earning per Share (EPS) trend, it indicated that the market's willingness to pay for the company's earnings has increased. This indicates that the market foresees Amazon's long-term prospects over and above its current position. As at 3rd quarter 2009, the EPS was \$1.20 and to grow further based on the company's projection on higher earnings in 4th quarter. Analyst predicts that strong online holiday sales will boost the shares of retailers, including Amazon and has recommended that the said shares will outperform in the market (Reuters.com, 2009).

In terms of market performance, Amazon's share price fluctuates throughout the years and increased tremendously in 2007 at \$92.64 due to the launch of its e-book reader, Kindle. However, during the economy downturn in 2008, the share price dropped to \$51.28 due to low operating profit as Amazon begins its price reduction for the goods and services. In 2009, the share price gradually increased and after the 3rd quarter results, it continuously went up and as at 11 December 2009, the share price was \$134.15. The current Price/Earning Ratio has increased to 80.70 times from 33.80 times in 2008.

Analyst predicted that with a strong revenue growth Amazon would be able to gain significant market share from other competitors (Stahl, 2009).

Due to the economic downturn, all companies are affected which was reflected in its performance. Similar to Amazon, Ebay's and BN's share prices had an initial stable growth but in 2008 it dropped by about 50%. While others are still struggling to recover from the economic situation, Amazon has showed a growth in 2009 and the share price has currently increased by 168% compared to Ebay and BN at 70% and 62% respectively.

Cash flow Analysis

As at 3rd quarter 2009, the cash and cash equivalents was \$2, 514, which a reduction from the opening balances at the beginning of the year of \$2, 769. During the period, the cash used in financing activities was \$229 million compared to \$1, 199 million in 2008 of which the cash outflows results from repurchases of common stock, repayments of long-term debt. Repayments on long-term debt and payments on capital lease obligations were \$379 million for the 3rd quarter 2009 and \$335 million in 2008. Meanwhile, free cash flow was \$446 million for the quarter.

Throughout the years, Amazon has managed to have a positive cash flow from its operating activities. This indicates a good sign that the core operation of the company is generating income. In comparison of Amazon's total liabilities to the cash flow generated from operations, the company has enough funds to cover level of investment and takes about 3. 3 years to pay back all its financial commitments. With the current cash, cash equivalents,

and marketable securities balances, the company is likely to be able to meet its anticipated operating cash needs for at least the next 12 months.

In comparison between the cash flow from operating activities and net income, it indicated that Ebay has the higher ability compared to Amazon in managing its operating cash cycle through receivables, payables and inventory. The reason is that Ebay takes advantages of its payable days for as long as 361 days. Due to the similar business model, both companies have a negative cash cycle of which cash is generated from its payable and quick settlement payment from the customers.

Management of Working Capital

In terms of managing working capital, Amazon had maintained its positive cash flow being the highest at 2007 for an amount of \$1, 450. This indicates that the company is able to pay off its short-term liabilities and operating expenses accordingly. In comparison between the competitors, Ebay has the highest working capital of \$4, 023 million in 2007 while BN has the lowest at \$841million in 2006. The high working capital for Ebay has enabled the company to be successful in its expansion programme and improve their operations.

For the 3rd quarter ending 31st December, Amazon's working capital is \$1, 832 million and is expected to increase further due to higher expectation of sales in the coming quarter.

Working capital provides information on the company's underlying operational efficiency. In terms of efficiency, Amazon is efficient in using its assets in generating sales compared to its competitors, which are reflected

in the asset turnover ratio. This indicates Amazon's improved efficiency in inventory and asset management that is partly supported from the low pricing strategy and low profit margin.

In comparison to the competitors, BN has the lowest account receivable days due to its retail business model, which is based on the cash transaction.

Based on the account payable days, Ebay has taken advantage on the free source of finance for the business at 361 days compared to Amazon at 62 days. In respect of the inventory days, Amazon is able to turn the inventory quickly as low as 12 days compared to BN at 140 days. BN has high stock inventory days due to the reason of its retailing business model and product which requires some time to be sold. Due to the same business application, both Amazon and Ebay have a negative cash operating cycle, which indicates efficiency in cash management. In term of the industry standard, the three companies are performing above the indicative ratios, which are supported by the significant growth in the industry.

Based on the industry standard, Amazon and the competitors are performing ahead from the standard. For the assets turnover ratio, Amazon was the highest at 2 times compared to 0.7 times industry standard. This indicates the company's efficiency at using its assets in generating sales. The reason Amazon performed better than the competitors is relatively derive from the pricing strategy wherein low profit margin company tends to have high asset turnover.

Amazon Future Prospects

Based on Amazon's current performance, it is projected that the company will have a strong growth supported by the low pricing strategy and free shipping. Moreover, the latest acquisition of Zappos. com and improvised version of Kindle are expected to increase Amazon' sales which leads to higher profitability. Due to the growth of Amazon, its annual earning is expected to grow over the next two to three years with sales reaching \$2. 38 million and \$2. 86 million respectively. Due to robust financial performance during the current economic condition, it has enhances investor's confidence. Share prices are expected to increase with earnings of \$2. 57 and \$2. 38 per share in 2008 and 2009 respectively. In line with the said growth, Amazon will benefit in gaining additional market share despite tough competition from other online sites such as Ebay.

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