

# [Google vs yahoo financial analysis essay](https://assignbuster.com/google-vs-yahoo-financial-analysis-essay/)

Dee Wassenberg Columbia College FINC 350 Business Finance Instructor: Darryl Sanborn February 11, 2011 Liquidity ratios, like the current ratio, provide information about a firm’s ability to meet its short time financial obligations. Short-term creditors seek a high current ratio from prospective clients since it reduces their risk. For investors in a company, such as shareholders, a lower ratio is sought, so that more of a firm’s assets are working to grow the business.

When computing financial relationships, a good indication of the company’s financial strengths and weaknesses becomes clear. Examining these ratios over time provides insight as to how effectively the business is being operated. The general consensus on liquidity ratios is; the higher the better, especially if a firm is reliant on any significant extent on creditors to finance their assets. Financial Ratios for Google, Yahoo and the Internet Information Providers Industry (based on 2005 and 2006 Fiscal Year Financial Information) Google, Inc.

Yahoo, Inc. Industry Liquidity Analysis Ratios: Current Ratio10. 02. 53. 2 Net Working Capital Ratio0. 60. 2N/A Profitability Analysis Ratios: Return on Assets (ROA)5. 4%1. 7%2. 1% Return on Equity (ROE)5. 8%2. 1%2. 2% Profit Margin29. 0%11. 7%24. 0% Activity Analysis Ratios: Assets Turnover Ratio0. 20. 10. 1 Accounts Receivable Turnover Ratio2. 61. 91. 1 Capital Structure Analysis Ratios: Debt to Equity Ratio0. 10. 30. 3 Interest Coverage Ratio3. 45. 31. 2

Taking the two liquidity analysis ratios, current and net working capital as seen in the table on the previous page, one can clearly see from its high current ratio that Google is in a far better position than both Yahoo and other firms in the Internet Information Providers Industry to quickly convert its assets into cash if the need arises. Google’s high networking capital ratio, is an indication that the company also is more reliant on creditors to finance its abundant level of revenue producing assets.

Profitability ratios such as the (gross) profit margin, is a measure of a firm’s gross profit earned on sales. The (gross) profit margin while considering the firm’s cost of goods sold does not include any other cost. As can be seen in the previous chart, all three profitability ratios for Google are considerably higher than of Yahoo and the industry average, which in short means that for 2006, Google was more effective at managing its return on assets and equity, resulting in the company’s substantially increased level of profitability over its peers.

For Activity Ratios the asset turnover ratio calculates the total sales (revenue) for every dollar of assets a company owns. A receivables turnover ratio can be used to quantify a firm’s effectiveness in extending credit as well as collecting debts. A high ratio implies either that a company operates on a cash basis or that its extension of credit and collection of accounts receivable is efficient. A low ratio on the other hand, implies a company should re-assess its credit policies in order to ensure the timely collection of credit accounts that are not earning interest for the firm.

In viewing the two activity ratios on the preceding page, it can be seen that from Google’s higher asset turnover ratio that the company is generating twice revenue per dollar spent as Yahoo, and that it’s higher accounts receivables turnover ratio is an indication that Google is far more adept at managing its extended credit accounts than both Yahoo and its industry peers. For Capital Structure Ratios, the debt ratio, a financial leverage ratio, is an indication of the long-term solvency of an entity.

Unlike a liquidity ratio which focuses on a firm’s short-term assets and liabilities, a financial leverage ratio like the debt ratio, measures the extent to which a firm is using its long-term debt. Companies finance their operations through either debt or equity. The debt-to-capital ratio provides an interested party with an idea of a company’s financial structure, or how it is financing its operations, along with some insight into its financial strength. The higher the debt-to-equity ratio, the more debt the company has compared to its equity.

A company with high debt-to-equity ratios, compared to a general or industry average, may show weak financial strength because the cost of these debts may weigh on the company and increase its default risk. Customarily, a capital structure ratio over 50% indicates that a company may be near their borrowing limit (often 65%). Google’s 10% debt-to-ratio is an indication that the company is effectively managing its debt load, and is considerably stronger than Yahoo and its peers in terms of it financial strength.

Borrowing money is one of the most effective things a company can do to build its business. However, borrowing comes with a cost: the interest that is payable month after month, year after year. These interest payments can and do directly affect the company’s profitability. For this reason, a company’s ability to meet its interest obligations, which is an aspect of its financial solvency, is arguably one of the most important factors in the company’s return to shareholders. The interest coverage ratio provides an informative view of a company’s ability to pay interest charges on its debt.

The ‘ coverage’ aspect of the ratio indicates how many times the interest could be paid from available earnings, thereby providing a sense of the safety margin a company has for paying its interest for any period. A company that sustains earnings well above its interest requirements is in an excellent position to weather possible financial storms. By contrast, a company that barely manages to cover its interest costs may easily fall into financial difficulty up to and including bankruptcy, if its earnings suffer for even a single month.

Obviously, an interest-coverage ratio below 1 is an immediate indication that the company, regardless of its industry, is not generating sufficient cash to cover its interest payments. That said, an interest-coverage ratio of 1. 5 is generally considered the bare minimum level of comfort for any company in any industry. Google’s interest coverage ratio of 3. 4 for 2006, while not as high as Yahoo’s 5. 3, is still considerably higher than the industry average of 1. 2, and is undoubtedly due to the interest charged to Google’s debt load which came as a result of the company’s many acquisitions during 2005 and 2006.

As can be seen by the information contained in this report, financial ratios are a means by which an interested party can evaluate a company’s performance or health by using an accepted standard of comparisons of items from the company’s financial statement rather than a direct reading of the financial figures. In viewing just the financial ratios contained in this report, the success of Google in effectively managing its cash, assets, capital structure, and debt can be readily seen, for they are the reasons behind the company’s explosive growth, and as of the date of this report, the justification for the company’s $503. 0 per share stock price.

### References

Google, (2007). Google 2006 Annual Report. Retrieved August 5, 2007, from Google, Incorporated

Web site: http://investor. google. com/releases/2006Q4. html MSN Money, (2007).

Google Key Financial Ratios. Retrieved August 5, 2007, from MSN Money

Web site: http://moneycentral. msn. com/investor/invsub/results/compare. asp? Page= FinancialCondition= GOOG Yahoo, (2007). Yahoo 2006 Annual Report. Retrieved August 5, 2007, from Yahoo Financial Filings

Web site: http://yhoo. client. shareholder. com/annuals. cfm