

Analysis of bmw financial position and performance accounting essay



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This is a financial analysis report on BMW. Specifically, in the first part of this report, the financial position and performance of BMW for the four financial years from 2008 to 2011 will be firstly re-formulated, and the financial ratios for the company will be computed - for analysis purposes. In order to perform a throughout financial analysis on the company, the trends of the financial ratios of BMW will be analyzed. Then, the financial statements of Audi will also be reformulated and the respective financial ratios for Audi will also be computed. The financial performance of Audi will be used to compare to the performance of BMW, to gauge the relative performance of BMW, as compared to one of the peer within the industry. Then, in the second part, BMW's forecasted value of equity per share at the end of the fourth financial (i. e., at FY 2011) will also be computed. Recommendations will be provided if the stock is a good investment choice, based on the various findings derived from this study.

1. 2 Company Background

Today, BMW is the world's best-selling manufacturer of premium cars (Rauwald, 2012). BMW is founded in 1916; and is headquartered in Munich, Germany. Today, the company has more than 96, 000 workforces at 24 production facilities in 13 countries and had penetrated to around 140 countries in the world (Avery & Bergsteiner, 2011). BMW is also a company emphasizing on corporate social responsibilities (Stamoulakis & Bridwell, 2009). Some of the competitors of BMW include Audi and Mercedes-Benz, whereby these companies has also been competing with BMW in important markets such as China (Rauwald & Pearson, 2011a). Referring to Table 1 below, the various business segments BMW is operating within is shown. The

major revenue contribution of the company comes from selling automobiles, and then followed by car financing activities.

Table 1: The Various Business Segments BMW Operating Within

Source: Worldscope

Table 2 below however shows the various geographical regions BMW is operating within. As shown from the figure, the revenue generated from BMW sales in China is improving fast, while the revenue generated from the United States are stagnating. Indeed, prior to the financial crisis, United States is the biggest market for BMW (Rauwald, 2010). In contrast, as discussed in Muller (2010), BMW growth in recent years had largely driven by the increase of sales from emerging countries. This is a trend worth acknowledging in analyzing the current financial performance and to predict the future probable performance of the firm.

Table 2: The Various Geographical Region BMW Operating Within

Source: Worldscope

Part I: Analysis of BMW Financial Position and Performance

In Part I, the financial analysis on BMW will be performed through two major methods, firstly by reviewing the trends of the financial metrics of BMW and its competitor; and secondly, through the review of various financial ratios of BMW – and to compare the ratios to the competitors' ratios.

2. 1 Trend Analysis – A Review of BMW Past Performances

2. 1. 1 Profitability Ratios

Based on Table 3 below, the various profitability ratios of BMW are shown. As measured by the Return on Assets, Return on Equity and Return on Invested Capital, BMW performance is generally well-performing in FY2007, but subsequently suffered to a minimal profitability in FY2008 towards FY 2010, before returning to superior profitability situation in FY2011. This is not surprising. In FY2008, the world financial crisis hit, and the automotive industry, which is cyclical in nature, are impacted adversely (Peterson, 2008). Indeed, the entire automotive industry fall into a turmoil – as auto sales have plunged in the United State and Europe; while sales faced stagnation in previously booming markets like China and India (Rauwald, 2009b). In 2009, as discussed within Rauwald (2009a), BMW suffered losses due to recession as the sales and demand of luxury cars stalled. This is logical as in recessionary period, people cut down spending – and luxury product manufacturers are often the most impacted as the product demand are highly elastic.

Then, qualitatively speaking, in FY 2010, the profitability improvement in BMW is due to improved efficiency significantly in all areas of the company (during the restructuring programme of BMW in the global financial crisis) as well as favourable exchange-rate fluctuations for the company (Rauwald, 2010). Next, Rauwald & Schmidt (2012a) had however attributed the significant enhanced of BMW performance due to the company's comprehensive transformation, via cutting jobs and costs since 2007 (which include a cut of more than 8, 100 jobs and reduction of more than 6 billion

Euros in costs). This is also true as based on the employee per sales figure, the company is showing positive improvement as in recent years, more sales are generated per employee.

Aside from that, it is also observed that the ratio of research and development to sales ratios has also been high, approximately around 5%. This is because BMW has been investing in research and development activities for further innovations in the future. For example, one of the recent innovations of BMW is development of eco-super car through the Vision Efficient Dynamics concept (Kable, 2010).

Overall, based on the profitability ratios, a gross profit margin of 24% and the Return on Equity ratio of 19. 2% in the recent years suggest that BMW is a well performing firm. Nonetheless, the fact that the firm could be seriously affected by recession also suggests that the business is cyclical, and therefore, the business risk faced by the firm and investors could be high.

Table 3: Trends of Profitability Ratios of BMW

Source: Worldscope

2. 1. 2 Asset Utilization Ratios

Based on Table 4 below, the various asset utilization ratios, such as assets per employee, total assets turnover, inventory turnover and net sales to gross fixed assets are shown. Overall, there is a trend of improvement on these ratios. As discussed in Rauwald & Schmidt (2012b), the strong performance of BMW is primarily contributed by the strength of the BMW, MINI and Rolls-Royce brands as well as improvements in efficiency. The

improved of efficiencies can be noted as the assets per employees had increased (i. e., fewer employees as compared to the total assets), and the higher total assets and inventory turnover ratios (as the company is more able to generate more sales from every unit of asset).

Table 4: Trends of Asset Utilization Ratios of BMW

Source: Worldscope

2. 1. 3 Leverage Ratios

Based on Table 5 below, the trends of use of debt financing and capital structure of BMW are shown. Overall, it can be noticed that BMW is a highly geared firm, as the long term debt within the capital structure has been consistently high throughout the past few years, i. e., at approximately 60%. Then, the portion of debt is also far outweigh the portion of equity, and as indicated by the total debt to common equity ratio, the total debt is approximately more than 2 to 3 times the total amount of equity. Overall, this suggests that BMW is heavily leveraged and the firm would face higher finance risks (such as solvency, liquidity and interest payment risks) in hard times. In contrast, the firm would make high return on equity for the shareholders due to use of leverage. Therefore, part of the reasons contributing to the high return on equity for BMW is through the use of high leverage within the firm.

Table 5: Trends of Leverage Ratios of BMW

Source: Worldscope

2. 1. 4 Liquidity Ratios

Based on Table 6 below, the various liquidity ratios such as quick ratio and current ratio are shown. Overall, the liquidity position of BMW is marginally satisfactory, as the current and quick ratio fall around the range of 1. A more conservative ratio would be a current ratio of more than 2 times. Then, it is also noted that throughout the years, the proportion of receivables in the current assets is the highest, followed by cash, and then inventories. This is however unavoidable, as most of the customers would purchase the luxury cars on credit.

Table 6: Trends of Liquidity Ratios of BMW

Source: Worldscope

2. 1. 5 A Review of the Financial Performance Trends of BMW

In order to form an overview of the financial performance of BMW in the past few years, the general profitability picture of BMW is presented in Figure 1. As shown below, prior to the crisis, BMW has been in a rising profit position for more than a decade (Avery & Bergsteiner, 2011). However, unfortunately, the firm performance is badly affected during the global financial crisis (as discussed previously). During the period of financial crisis, the net income, return on equity and total common equity fall sharply. Nevertheless, upon the crisis, the profitability of BMW surged sharply. Avery & Bergsteiner (2011) had found that one of the reasons contribute to fast BMW recovery from the global financial crisis in 2008 is due to sustainable leadership model and processes within the company. Therefore, this

suggests the resiliency and the quality of the management within the firm as satisfactory and competent.

Then, another trend worth discussing is that in the recent years, BMW car sales have been increasing significantly in the China market (Rauwald, 2012). Indeed, as discussed within Schafer (2011), much of the sales increases of BMW come from the growth of sales from China and India. Such a trend had contributed significantly as even in FY2011 and FY2012, BMW sales in Europe are facing challenges due to sovereign debt crisis (Rauwald & Pearson, 2011a). Similarly, as discussed within Schafer (2011), the sales of BMW cars are slow in Europe due to the slow recovery within the region.

Figure 1: Net Income, Equity, ROE and ROCI Trends of BMW

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Source: Worldscope

2. 2 Peers' Financial Ratios Comparisons

In this section, in order to understand the financial position and the performance of BMW in the context of its industry as well as in relation to its peers, the various financial ratios of BMW, the peers and one of its leading competitors, namely Audi will be performed.

2. 2. 1 Growth Rates related Ratios

As shown in Table 7, the various growth rates of BMW is compared to the peers and Audi. Firstly, it is noted that the growth of sales of BMW is slightly

worse than the growth of Audi, but significantly worse off than the peers. In other words, both Audi and BMW are performing less satisfactorily as compared to the industry average. Therefore, while the financial picture of BMW is recovering and experiencing sharp upturns in FY2011, the firm is actually down perform as compared to the industry average.

Table 7: Trends of Growth Rates of BMW, Audi and Peers

Company

BMW AG

Peer Mean

Audi AG

Last Fiscal Yr End Date

12/31/2011

12/31/2011

Key 1 Year Growth Rates

Sales 1Yr Growth

13. 80

22. 22

24. 42

Operating Income 1Yr Growth

53. 21

47. 75

57. 09

Net Margin 1Yr Growth

32. 92

104. 88

36. 41

Net Income 1Yr Growth

51. 26

149. 43

69. 72

EPS 1Yr Growth

51. 12

146. 47

69. 73

Total Assets 1Yr Growth

11. 71

14. 54

19. 56

Equity 1Yr Growth

13. 11

8. 58

13. 72

Key 5 Year Growth Rates

Sales 5Yr Growth

7. 03

15. 17

7. 20

Operating Income 5Yr Growth

16. 39

23. 44

14. 71

Net Margin 5Yr Growth

3. 92

7. 76

18. 21

Net Income 5Yr Growth

11. 22

23. 09

26. 72

EPS 5Yr Growth

11. 21

21. 35

26. 72

Total Assets 5Yr Growth

9. 18

12. 25

14. 00

Equity 5Yr Growth

7. 17

9. 09

11. 83

Source: Thomson One Banker

As shown in Table 8, the figures of growth rates of several financial metrics are also computed, from the reformulated financial statements (as shown in Appendix at the end of this document). Overall, it can be observed that both Audi and BMW financial performance move in tandem, whereby the good performance of both company tend to be happen at the similar time. For instance, the growth of sales was negative for both of the firm at FY2009. Then, the growth rates of common shareholder equity also tend to be similar in terms of magnitude. For example, the growth rate of shareholder equity has been slight negative or positive at FY2009. However, the growth rate of operating income (after tax) for both the company tend to be less similar. This could be due to the operational management differences between the two firms.

Table 8: Trends of Growth Rates of BMW to Audi

Profitability R

2009

2010

2011

Growth Rate in Sales

BMW

-4.73%

19.33%

13.80%

Audi

-12.74%

18.77%

24.42%

Growth Rate in OI (after tax)

BMW

352.36%

-20.66%

49.91%

Audi

-43.17%

128.13%

60.40%

Growth Rate in NOA

BMW

31.36%

13.02%

-10.94%

Audi

10.86%

47.64%

-4.07%

Growth Rate in CSE

BMW

-1.79%

15.94%

17.18%

Audi

2.62%

9.30%

13. 72%

Source: Computed from Reformulated Financial Statement

2. 2. 2 Profitability Ratios

As shown in Table 9, the profitability related ratios for BMW, peers and Audi are shown. Overall, the profitability margins of BMW would be slightly lesser than that of the Audi (particularly from the net margin perspective), but would be higher than that of the peers. This is because BMW operate within the luxury car segment, and therefore, the margins would be higher, as the majority of other competitors go for the volume for profitability. Therefore, the asset turnover of BMW and Audi is lower significantly than the peers, as the company focus on the luxury niche segment. Aside from that, it could be seen that the R&D expense to sales ratio for BMW (and Audi) is higher than that of the peers. For this, one of the successes of BMW comes from investing heavily in extra production capacity and new technology constantly (Rauwald, 2012).

Table 9: Profitability Related Ratios for BMW, Peers and Audi

Company

BMW AG

Peer Mean

Audi AG

Last Fiscal Yr End Date

12/31/2011

12/31/2011

Asset Turnover

0. 57

0. 85

1. 25

Pretax Margin

10. 73

13. 70

ROA

4. 37

13. 86

Return on Invest Cap

5. 62

34. 13

Reinvest Rate

13. 25

37. 59

35. 68

R & D to Sales

4. 90

3. 43

5. 09

Gross Profit Margin

24. 62

19. 45

18. 57

Operating Profit Margin

11. 42

6. 92

9. 54

Pretax Margin

10. 73

13. 70

Net Margin

7. 09

9. 95

Source: Thomson One Banker

Table 10 is about the profitability ratios of BMW and Audi, computed from the reformulated financial statements (as shown in Appendix at the end of this document). Overall, it can be seen that Audi would perform slightly better than BMW, although from the net profit margin perspective, BMW outperform Audi in FY2010 and FY2011. Then, it is also observed that the financial margins of BMW are more volatile as compared to Audi. Therefore, the risks (from the standard deviation perspective) for BMW are higher. Nonetheless, as discussed before, BMW is performing well in terms of cutting down the expense. This can be observed as the portion of administration costs to the sales ratio for BMW has been decreasing from FY2008 towards FY2011; whereby the ratio for Audi had been staying relatively constant (around 8-10%). This reaffirm that BMW had been slowly transform itself into a more efficient organization.

Table 10: Trends of Profitability Ratios of BMW to Audi

2008

2009

2010

2011

Operating Profit Margin

BMW

0.95%

-0.09%

5.71%

8.03%

Audi

5.27%

3.43%

6.59%

8.50%

Sales Profit Margin

BMW

1.95%

9.27%

6.17%

8.12%

Audi

5. 27%

3. 43%

6. 59%

8. 50%

Other Items Profit Margin

BMW

0. 00%

0. 00%

0. 00%

0. 00%

Audi

2. 82%

2. 86%

2. 87%

2. 90%

Net Profit Margin

BMW

1. 25%

0. 13%

5. 23%

7. 75%

Audi

6. 46%

3. 52%

3. 07%

5. 91%

Expense Ratio Admin Costs

BMW

9. 59%

9. 91%

7. 98%

7. 83%

Audi

9. 47%

10. 52%

8. 57%

8. 16%

Expense Ratio Distribution Costs

BMW

-0. 21%

0. 10%

0. 24%

0. 50%

Audi

0. 88%

1. 01%

1. 06%

0. 97%

Operating Profitability (RNOA)

BMW

N/A

14. 55%

9. 55%

14. 27%

Audi

N/A

12. 48%

21. 87%

30. 03%

Financing Profitability (RNFA)

BMW

N/A

0. 70%

0. 98%

1. 37%

Audi

N/A

5. 07%

5. 54%

9. 98%

Source: Computed from Reformulated Financial Statement

2. 2. 3 Asset Utilization ratios

Table 11 is about the asset utilization related ratios for BMW, Audi and peers. Overall, BMW down perform both Audi and the peers – from asset turnover and inventory turnover perspective. Indeed, Audi perform best in utilizing assets in generating revenue. This shown that BMW may not be effective to the peers and Audi in leveraging on the assets to generate sales, and there are much room for improvement to significantly enhance the asset utilization ratios for the firm.

Table 11: Asset Utilization Related Ratios for BMW, Audi and Peers

Company

BMW AG

Peer Mean

Audi AG

Last Fiscal Yr End Date

12/31/2011

12/31/2011

Asset Turnover

0. 57

0. 85

1. 25

Inventory Turnover

5. 11

8. 52

8. 85

Source: Thomson One Banker

2. 2. 4 Leverage Ratios

Table 12 is about the comparisons of leverage related ratios between BMW, Audi and peers. Obviously from the figure of the industry mean score, it can be noticed that most of the automotive manufacturers are highly geared. Indeed, as it is discussed that BMW is a firm that relied heavily on debt instrument for financing its operations, the industry average figure is even higher. In stark contrast, Audi is a lowly leveraged firm. Indeed, the use of debt is very minor within the firm's capital structure.

Table 12: Leverage Ratios Related Ratios for BMW, Audi and Peers

Company

BMW AG

Peer Mean

Audi AG

Last Fiscal Yr End Date

12/31/2011

12/31/2011

Total Debt to Common Equity

245.94%

250.96%

9.39%

LT Debt to Common Equity

133.58%

146.61%

0.17%

LT Debt to Total Capital

56.96%

41. 23%

0. 16%

Dividend Payout

17. 46%

15. 80%

0. 00%

Cash Dividend Coverage Ratio

7. 13

21. 08

#N/A

Source: Thomson One Banker

In Table 13 below, trends of leverage ratios of BMW and Audi, computed from the reformulated financial statements (as shown in Appendix at the end of this document) are presented. Similar to the discussions presented above, the financial leverage ratio of BMW is significantly higher than the case of Audi. However, from the operating liability leverage ratio perspective, the figures of the two firms are roughly comparable.

Table 13: Trends of Leverage Ratios of BMW to Audi

2008

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2009

2010

2011

Financial Leverage Ratio (FLEV)

BMW

0.299

0.414

0.413

0.410

Audi

0.256

0.198

-0.128

0.054

Capitalization Ratio

BMW

1.378

1. 843

1. 796

1. 365

Audi

0. 781

0. 844

1. 140

0. 962

Operating Liability Leverage Ratio (OLLEV)

BMW

1. 093

0. 663

0. 645

1. 011

Audi

1. 479

1. 381

1. 058

1. 268

Source: Computed from Reformulated Financial Statement

2. 2. 5 Liquidity Ratios

In Table 14 below, the liquidity related ratios for BMW, Audi and peers are compared and presented. It is noted that the liquidity position of BMW, as measured from all of these ratios, i. e., quick ratio, current ratio, cash and equivalent to current assets ratio, account receivables days as well as inventories days held are not only down performing the peers, but also perform much badly as compared to the situation of Audi. Indeed, Audi is having strong liquidity position, thereby indicating that the firm is unlikely to suffer from any near term liquidity issues. Audi had also outperformed the peers significantly – and based on the findings above that Audi is a lowly geared firm; the firm is financially conservatively managed.

Table 14: Liquidity Related Ratios for BMW, Audi and Peers

Company

BMW AG

Peer Mean

Audi AG

Last Fiscal Yr End Date

12/31/2011

12/31/2011

Quick Ratio

0. 82

1. 00

1. 32

Current Ratio

1. 04

1. 28

1. 60

Cash & Equivalent to Current Assets

23. 52

32. 24

41. 13

Accounts Receivable Days

136. 25

102. 07

61. 22

Inventories Days Held

71. 44

48. 60

41. 24

Source: Thomson One Banker

2. 2. 6 Summary

Overall, while BMW is a profitable firm, and the firm is performing very well in FY2011 (i. e., experiencing sharp recovery) – such performance can be largely attributed to the industry wide recovery situation around the world. However, the performance of BMW would seem to be lacking, more risky and less efficiently, effectively and conservatively managed when compared to the peers. This is particularly when compared to Audi, as Audi had found to be having much stronger and yet conservative financial position and performance. It can be summarized that BMW performed unsatisfactorily as compared to the other automotive manufacturers.

Part II: Valuation

In this section, valuation of BMW stock will be performed via the discount cash flow model. In order to compute the company value via this method, the dividend distributed to the investors will be treated as the proxy of the cash flow to the investors. Currently, the latest dividend payment from BMW is EUR 2. 30 (Figure 2, the indicated dividend payment from the

management). Then, from Figure 3, the growth rate of the dividend yield/ payment (i. e., the growth rate of the cash flow of the firm) range from 0. 23% (i. e., 3-years growth rate) to 1. 01% (i. e., 3-years growth rate). Theoretically, the longer term growth rate should be used. However, the global financial meltdown in FY2008 to FY2009 would be considered as anomalies (the black swan event), and therefore, it is unfair to take the three year average figure for the firm. Therefore, conservatively, a growth rate of 0. 5% would be assumed to represent the growth rate of dividend payment for the investors. Then, in order to compute the required rate of return for BMW, the risks pertaining to the firm will be considered. As BMW is found to be highly geared, a required rate of return of above 10% would be necessary. Therefore, conservatively speaking, a required rate of return of 15% is justifiable.

Hence:

$$D = \text{EUR } 2.30$$

$$g = 0.5\%$$

$$r = 15\%$$

Firm value

=

$$D (1+g)$$

$$(r-g)$$

=

2.3 (1+0.005)

(0.15-0.005)

=

2.3 (1.005)

(0.145)

=

EUR 15.94

Therefore, a very conservative firm value for BMW from the dividend discount model (i. e., Gordon Growth Model valuation method) is only EUR 15.94. This is even much lower than the analysts target price of EUR 75.60 (Figure 2). Therefore, from the valuation method applied, it is unwise to purchase into BMW stock.

Figure 2: Estimates from Analyst

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Source: Thomson Financial

Figure 3: Estimates from Analyst

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Source: Thomson Financial

In Table 15 below, the price multiple of BMW, peers and Audi is shown. It is shown that BMW stock prices is valued at 10 times earnings multiple, as compared to Audi (which is only 5 times earnings multiple). Indeed, from the other two yardsticks, namely price to book value and price to cash flow ratios, BMW stock is valued more expensively. Then considering that the financial position and performance of BMW is significantly lower than the peers, and particularly, to Audi, the high price multiples of BMW would justify a 'sell' comment on the stock.

Table 15: Market Value Related Ratios for BMW, Audi and Peers

Company

BMW AG

Peer Mean

Audi AG

Last Fiscal Yr End Date

12/31/2011

12/31/2011

Current P/E Ratio

10. 17

5. 15

Price/Book Ratio

1. 84

1. 33

1. 81

Price/Cash Flow Ratio

-11. 10

1. 94

3. 34

Source: Thomson One Banker

Then, from the qualitative perspective however, looking forward, competition between automotive manufacturers in China could be intensifying – and this could affect how BMW compete with other car manufacturers (Rauwald, 2012). However, some analysts had also been optimistic as they anticipate growth in markets such as China and Russia – which would contribute to higher BMW sales in these emerging regions (Rauwald & Schmidt, 2012a). Then, as discussed in Reed & Schafer (2010), the rise of sales in China is primarily due to the branding and the quality of the cars sold by BMW. Therefore, the growth story of BMW in emerging regions would be in doubts, as the competitors, such as Audi has also strong performance in these

emerging regions. Therefore, from a more conservatively perspective, it is reasonable to conclude that even it is expected that BMW could profit from the emerging countries, which would also not justify the high valuation of the stock. Hence, it is not rational to purchase into the stock of the company at the current price. In contrast, investors seeking exposure to automotive industry would be better to purchase the stock of Audi, as the firm is financially conservatively and operational effectively managed, and yet, having a low price multiple.

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