Financial Ratio Analysis Report

MM 520 Accounting and Finance for Managerial Decision Making

Abstract

This paper will analyze the financial ratio of Apple, a Fortune 500 company. Research for this Apple will be taken from Apple's website and the University of Phoenix online library. The paper will focus on the following information as it is listed below. Three to five year trend tables of 12-15 of the financial ratios we consider the most important for Apple for the most recent year, and a brief rationale for each ratio we have calculated. Ratios calculated against industry averages will then be compared. For

each ratio calculated, we will interpret the trends and identify strengths and weaknesses. We will assess the financial condition of Apple and discuss other factors beyond the ratios that need to be considered in the assessment of the Apple's health. We will also discuss how our assessment compares to what management is telling the shareholders in the annual report. We will also identify possible problems one may see this company facing in the next year that would require further analysis and exploration. We will identify a key new management initiative that is detailed in the Apple's annual report, using financial ratios to assess the Apple's preparedness to launch this initiative. Finally, what non-financial considerations need to be evaluated in order to determine the likelihood of the initiative's success?

Financial Ratio Analysis Report

Apple Computer Incorporated, is a Fortune 500 company that "designs, manufactures, and markets personal computers and related software, services, peripherals and networking devices" (Mergentonline, 2004) You must include the page number when quoting directly. If quoting an online source, you must include the paragraph number. Additionally, Apple "designs, develops and markets a line of portable digital music players along with related accessories and services including the online distribution of third-party music and audio books" (Mergentonline, 2004) You must include the page number when quoting directly. If quoting an online source, you must include the paragraph number.. In this paper, we will discuss financial trends, calculate three key financial ratios, present a financial recommendation, and review the dangers of basing business decisions on financial statements.

Financial Ratios

Financial statements, such as the income statement, balance sheet, and cash flow statement, can provide some insight into a company's financial viability but should not be the only determining factor for investors and analysts. Ratio analysis provides a more in-depth analysis of a company's financial status and may show financial trends. Exploring the multiple ratios available to investors and analysts will help understand the company's standings in terms of liability, profitability, activity, and debt compared to other companies in the industry. Investors and analysts should also examine several years of a company's financial status to determine trends to develop an accurate picture of how well the company operates and to help predict the company's future.

The current ratio can also be called the working capital ratio and provides a measure of the relationship between current assets and current liabilities. "It is the trend of a company's current ratio that is most useful in judging its current bill-paying ability" (Marshall, 2003, p.74). The current ratio measures current assets divided by current liabilities and "as a general rule, a current ratio of 2.0 … is considered indicative of adequate liquidity" (p. 74). Apple's current ratio has remained stable from 2003 to 2004 but is still twice as high as industry averages. This may be an indicator that Apple may have problems paying creditors if required.

Year:	2004	2003	2002	2001	2000

Company Name	Current Ratio	Current Ratio	Current Ratio	Current Ratio	Current Ratio
	Peer Avg: 1.57	Peer Avg: 1.56	Peer Avg: 1.75	Peer Avg: 1.89	Peer Avg: 1.76
Apple Computer Inc.	2.63	2.5	3.25	3.39	2.81
Dell Inc	0.98	1	1.05	1.45	1.48
Hewlett-Packard Co. (DE) (United States)	1.5	1.54	1.48	1.53	1.53
International Business Machines Corp.	1.18	1.19	1.21	1.21	1.21

"The debt to assets ratio reveals the extent to which a company is financed with debt" (Bankrate.com, 2005a, para 1) Please correct your citation…. For online sources, try the steps above; if nothing applies, use the site's name (War of 1812, 2004). Note: a URL--(www.source.com)--is not a valid citation.

Creditors examine this ratio when deciding what the chances are the debtor will not be able pay business loans or obligations. A company should have a balance between debt and assets. Creditors look for a low number since this means the company may have a better chance of prospering during a slump in the market.

Year:	2004	2003	2002	2001	2000
Company Name	Debt/Total Assets	Debt/Total Assets	Debt/Total Assets	Debt/Total Assets	Debt/Total Assets
	Peer Avg: 0.07	Peer Avg: 0.09	Peer Avg: 0.10	Peer Avg: 0.10	Peer Avg: 0.10
Apple Computer Inc.	-	-	0.05	0.05	0.04
Dell Inc	0.03	0.03	0.04	0.04	0.04
Hewlett-Packard Co. (DE) (United States)	0.06	0.09	0.09	0.11	0.1
International Business Machines Corp.	0.14	0.16	0.21	0.18	0.21

The long-term debt ratio is used to measure the amount of the capital structure or total capitalization which is made up of debt and lease obligations. A higher ratio means the company is using more financial leverage that poses an increased risk to return situation for investors.

Year:	2004	2003	2002	2001	2000
Company Name	Long-term Debt/Equity	Long-term Debt/Equity	Long-term Debt/Equity	Long-term Debt/Equity	Long-term Debt/Equity
	Peer Avg: 0.29	Peer Avg: 0.34	Peer Avg: 0.35	Peer Avg: 0.33	Peer Avg: 0.36
Apple Computer Inc.	-	-	0.08	0.08	0.07
Dell Inc	0.08	0.1	0.11	0.09	0.1
Hewlett-Packard Co. (DE) (United States)	0.17	0.18	0.19	0.27	0.25
International Business Machines Corp.	0.62	0.72	1.04	0.88	1.03

"The return on assets ratio measures how well a company's management team is doing its job" (Bankrate.com, 2005b, para 1). The ROA ratio reveals how well the company has managed the net income and average total assets. This ratio helps investors evaluate the company's leadership.

Year:	2004	2003	2002	2001	2000
Company Name	Return on Assets (ROA)	Return on Assets (ROA)	Return on Assets (ROA)	Return on Assets (ROA)	Return on Assets (ROA)
	Peer Avg: 7.36	Peer Avg: 6.35	Peer Avg: 3.62	Peer Avg: 6.67	Peer Avg: 11.43
Apple Computer Inc.	3.43	1	1.03	-0.61	11.55
Dell Inc	13.7	13.72	9.21	16.64	14.52
Hewlett-Packard Co. (DE) (United States)	4.59	3.4	-1.31	1.92	10.47
International Business Machines Corp.	7.74	7.29	5.53	8.75	9.16

The return of equity (ROE) ratio is also an important ratio to review for trends. "Owners (and others) are interested in expressing the profits of the firm as a rate of return on the amount of owners' equity" (Marshall, 2003, p. 73). The ROE ratio is calculated by dividing net income by shareholder equity. Net income is a company's total revenue less total expenses. The ROE shows what a company earned (or if lost, called net loss) for a set period, usually one year. "A rule of thumb for putting ROE in perspective is that average ROE for most American merchandising and manufacturing companies has historically ranged from 10% to 15%" (p. 73). Below is a chart showing Apple's ROE.

Year:	2004	2003	2002	2001	2000
Company Name	Return on Equity (ROE)	Return on Equity (ROE)	Return on Equity (ROE)	Return on Equity (ROE)	Return on Equity (ROE)
	Peer Avg: 21.32	Peer Avg: 19.80	Peer Avg: 12.25	Peer Avg: 19	Peer Avg: 28.71
Apple Computer Inc.	5.44	1.61	1.59	-0.94	19.14
Dell Inc	42.12	43.55	26.54	39.77	31.39
Hewlett-Packard Co. (DE) (United States)	9.31	6.73	-2.55	4.47	25.06
International Business Machines Corp.	28.4	27.32	23.41	32.71	39.24

"The acid-test ratio**,** also known as the quick ratio*,* is a more conservative short-term measure of liquidity because merchandise inventories are excluded from the computation" (Marshall, 2003, p. 75). Calculating this ratio reveals information about the "firm's ability to meet its current obligations even if none of the inventory can be sold" (p. 75). The acid-test ratio is calculated by adding the company's cash (including temporary cash investments) and accounts receivable and dividing the total by the company's current liabilities. The table below shows the acid test ratio for Apple.

Year:	2004	2003	2002	2001	2000
Company Name	Quick Ratio	Quick Ratio	Quick Ratio	Quick Ratio	Quick Ratio

	Peer Avg: 1.32	Peer Avg: 1.30	Peer Avg: 1.43	Peer Avg: 1.54	Peer Avg: 1.41
Apple Computer Inc.	2.43	2.26	2.96	3.16	2.58
Dell Inc	0.81	0.81	0.82	1.27	1.3
Hewlett-Packard Co. (DE) (United States)	1.08	1.15	0.96	0.79	0.83
International Business Machines Corp.	0.97	0.96	0.96	0.95	0.95

Operating revenue to total assets measures how effectively a company uses its total assets to generate revenue. Operating revenue to total assets ratio is also used to find the asset levels required to generate a gain in sales level. A company with a high ratio has a high productivity of capital. On the other hand, a low ratio means that the company may need better planning in areas such as investing, asset acquisition, marketing and financing. Apple is in line with industry averages.

Year:	2004	2003	2002	2001	2000
Company Name	Revenue/Total Assets	Revenue/Total Assets	Revenue/Total Assets	Revenue/Total Assets	Revenue/Total Assets
	Peer Avg: 1.28	Peer Avg: 1.26	Peer Avg: 1.21	Peer Avg: 1.41	Peer Avg: 1.45
Apple Computer Inc.	1.03	0.91	0.91	0.89	1.17
Dell Inc	2.15	2.29	2.3	2.37	2.2
Hewlett-Packard Co. (DE) (United States)	1.05	0.98	0.8	1.39	1.43
International Business Machines Corp.	0.88	0.85	0.84	0.97	1

The revenue to working capital projects how many times the company's working capital is being turned into revenue for the company. A very high value suggests the firm is under-capitalized and there may be liquidity problems. A very low value suggests the firm is not maximizing resources.

Year:	2004	2003	2002	2001	2000
Company Name	Revenues/Working Capital	Revenues/Working Capital	Revenues/Working Capital	Revenues/Working Capital	Revenues/Working Capital
	Peer Avg: (34.17)	Peer Avg: (978.59)	Peer Avg: 26.21	Peer Avg: 7.54	Peer Avg: 7.58
Apple Computer Inc.	1.89	1.76	1.54	1.48	2.28
Dell Inc	-157.58	-3933.78	87.06	10.82	10.15
Hewlett-Packard Co. (DE) (United States)	5.58	5.09	4.81	6.16	6.06
International Business Machines Corp.	13.43	12.56	11.43	11.7	11.83

Another ratio to explore is net profit. This ratio "measures the effectiveness of management" and "provides for a comparison between firms in the same industry" (Roux, 2005) need page number. The industry average is between 5% and 10%. When examining the net profit ratio, a "low ratio may mean that the expenses of doing business are too great. A high ratio may mean there is a high earning margin or expenses are being held down" (Roux, 2005) need page number. Apple flat lined in 2002 and 2003 but has shown signs of improvement in 2004.

Year:	2004	2003	2002	2001	2000
Company Name	Net Profit	Net Profit	Net Profit	Net Profit	Net Profit
	Peer Avg: 5.66	Peer Avg: 4.87	Peer Avg: 2.48	Peer Avg: 3.36	Peer Avg: 8.36
Apple Computer Inc.	3.33%	1.11%	1.13%	-.47%	9.85%
Dell Inc	6.18%	6.38%	5.99%	4%	6.83%
Hewlett-Packard Co. (DE) (United States)	4.38%	3.48%	-1.6%	.9%	7.58%
International Business Machines Corp.	8.75%	8.51%	4.41%	8.99%	9.16%

Working capital/total assets is a ratio helps investors understand the status of the corporate distress. "A firm with negative working capital is likely to experience problems meeting its short-term obligations - because there are simply not enough current assets to cover them (McClure, 2004, para. 6). On the other hand, a firm with significantly positive working capital is able to meet financial obligations. Apple is above industry standards.

Year:	2004	2003	2002	2001	2000
Company Name	Working Cap./Total Assets	Working Cap./Total Assets	Working Cap./Total Assets	Working Cap./Total Assets	Working Cap./Total Assets
	Peer Avg: 0.20	Peer Avg: 0.19	Peer Avg: 0.21	Peer Avg: 0.28	Peer Avg: 0.26
Apple Computer Inc.	0.54	0.52	0.59	0.6	0.51
Dell Inc	-0.01	0	0.03	0.22	0.22
Hewlett-Packard Co. (DE) (United States)	0.19	0.19	0.17	0.23	0.24
International Business Machines Corp.	0.07	0.07	0.07	0.08	0.08

The gross profit ratio reflects how much of each sales dollar the company can expect to use to cover operating expenses and profit. "In other words, it measures the difference between what it costs to produce a product and what you're selling it for" (Bankrate.com, 2005c, para 1) Please correct your citation…. For online sources, try the steps above; if nothing applies, use the site's name (War of 1812, 2004). Note: a URL--(www.source.com)--is not a valid citation. This ratio is useful in determine the company's future potential. Apply is below current industry averages.

Year:	2004	2003	2002	2001	2000
Company Name	Profit Margin	Profit Margin	Profit Margin	Profit Margin	Profit Margin
	Peer Avg: 5.71	Peer Avg: 4.77	Peer Avg: 1.99	Peer Avg: 4.06	Peer Avg: 8.29
Apple Computer Inc.	3.33	1.11	1.13	-0.47	9.85
Dell Inc	6.38	5.99	4	6.83	6.59

Hewlett-Packard Co. (DE) (United States)	4.38	3.48	-1.6	0.9	7.58
International Business Machines Corp.	8.75	8.51	4.41	8.99	9.16

One of the most significant measures of profitability that should be trended is the return on investment (ROI) ratio. "Return on investment measures the efficiency with which management has used the operating assets to generate operating income" (Marshall, 2003, p. 386). Over the last five years, Apple has had some turbulent times financially, and the company's ROI has fluctuated with a significant downward spiral as did Dell, and HP in 2001. Apple has begun to make a comeback with ROI of 15% in 2004 but is still below industry averages.

Year:	2004	2003	2002	2001	2000
Company Name	ROI	ROI	ROI	ROI	ROI
	Peer Avg: 253.42	Peer Avg: 204.31	Peer Avg: 152.42	Peer Avg: 93.73	Peer Avg: 202.75
Apple Computer Inc.	15.35%	4.83%	4.06%	-1.99%	58.15%
Dell Inc	32.25%	29.92%	15.92%	30.59%	31.81%
Hewlett-Packard Co. (DE) (United States)	883.37%	740.2%	601.58%	332.88%	615.91%
International Business Machines Corp.	82.72%	42.29%	-11.9%	13.42%	105.11%

From the data that has been provided by management, Apple has not been hiding any of the areas that are a concern. The Annual Report which has excerpts stated throughout the paper, shows that both management and the Annual Report are in line to what is being portrayed to the shareholders. Our research shows the ratios need work and the Annual Report shows that they are below average as well.

Over the next year, Apple will need to overcome the Gross profit margin ratio, and the ROI short falls. As stated above, the company is still below the standard average.

Apple as a company is doing well in other areas and it would prove crucial for managers and investors to continue to track all reports and ratios for further analysis and exploration.

Financial Condition

Apple reported the highest revenue and earnings in the company's history for its fiscal 2005 third quarter that ended June 25, 2005 (Apple Reports, 2005). This is Apple's best quarter in both revenue and earnings. This is a result from 1,182,000 Macintosh units and 6,155,000 iPods that were shipped during the quarter, representing 35 percent growth in Macs and 616 percent growth in iPods over the year-ago quarter. Apple is expecting that the fourth quarter fiscal 2005 to bring in revenue of $3.2 billion.

The other factors that need to be considered in the assessment of the company's health was (Snell, 2004) the iMac back in 1998, but since then it's the iPod, and many former iMac users are now graduating to PowerBooks and Power Macs. "The iMac G5 is more powerful than the previous iMac…slightly larger than the average flat-panel display is an impressive bit of engineering. Consider the challenge Apple's hardware designers faced in trying to get a G5 processor into such a small space" (2004). Snell (2004) continue to say that Apple believes that with the growth of wireless technologies and the continuing miniaturization of computer technology, it would not be too long before the desktop computer be embedded into a flat - panel monitor.

Key New Management Initiative

Apple Computer Incorporated "announced financial results for its fiscal 2005 second quarter ended March 26, 2005. For the quarter, the Company posted a net profit of $290 million, or $.34 per diluted share" (Apple Reports, 2005, para. 1). Apple's net profit in 2004 for the second quarter was "$46 million or $.06 per diluted share, in the year-ago quarter" (para. 1). Additionally revenues were $3.24 billion, "up 70 percent from the year-ago quarter" (para 1). Additionally, the company expanded international sales to 40 % of the 2nd quarter's revenue.

Apple has improved significantly its overall financial standing within the last year as noted in the 2nd quarter's revenues. Apple has increased production and expanded its market base that has increased operating leverage by changing the level of activity, and increasing profits by producing a product with the greatest contribution margin per unit. "Apple shipped 1,070,000 Macintosh(R) units and 5,311,000 iPods during the quarter, representing a 43 percent increase in CPU units and a 558 percent increase in iPods over the year-ago quarter" (Apple Reports Second Quarter Results, 2005, para. 2).

Additionally, Apple's management team believes "the Company's critical accounting estimates are those related to revenue recognition, allowance for doubtful accounts, inventory valuation and exposures related to inventory purchase commitments, valuation of long-lived assets including acquired intangibles, warranty costs, and income taxes" (Investors Relations, 2005, para 7).

Apple does need to consider its global market and possible terrorist acts against the company. Apple has to be concerned about doing business internationally especially with 40 % of sales derived from the international market. Variable cost may be caused by possible disruption in commercial activities caused by terrorist activity and armed conflict, such as changes in logistics and security arrangements, and reduced end-user purchases relative to expectations; possible disruption in commercial activity as a result of natural disasters or major health concerns including epidemics (Apple Reports, 2005, para. 6).

References

Apple Computer Inc. (2005). *Investors relations*. Retrieved July12, 2005, from http://www.apple.com/investor

Apple Reports Third Quarter Results, (2005). Retrieved July 17, 2005 from http://www.apple.com/ca/hotnews

Bankrate.com, (2005a). Debt to assets ratio calculator. Retrieved July 12, 2005, from Bankrate.com Web site: http://www.bankrate.com/brm/news/biz/bizcalcs/ratiodebt.asp.

Bankrate.com, (2005b). Return on assets ratio calculator. Retrieved July 12, 2005, from Bankrate.com Web site: http://www.bankrate.com/brm/news/biz/bizcalcs/ratioreturn.asp

Bankrate.com, (2005c). Gross profit margin ratio calculator. Retrieved July 12, 2005, from Bankrate.com Web site: http://www.bankrate.com/brm/news/biz/bizcalcs/ratiogross.asp

Marshall, D. H., McManus, W. W., & Viele, D. F. (2003). Accounting: What the numbers mean (6th ed.). Boston: Irwin McGraw-Hill.

McClure, B. (2004). Z marks the end. Retrieved July 12, 2005, from Investopedia.com Web site: http://www.investopedia.com/printable.asp

Mergentonline (2004). Retrieved June 25, 2005, from the University of Phoenix University, Company and Financials Web Site: Mergent Online database

PR Newswire, (n.d.). Apple reports second quarter results. Retrieved Jul. 11, 2005, from News and Information Web site: http://sev.prnewswire.com/consumer-electronics

Snell, J. (2004). The Once and Future iMac. *Macworld,* 21 (11) p.5. Retrieved July 17, 2005 from the EbscoHost database