

Financial Analysis

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Financial Analysis

Financial statement analysis is essential in assessing the performance of a firm in the industry and comparing the performance with that of another firm. The analysis can be done using vertical comparative analysis, ratios and horizontal comparative analysis. The purpose of the essay is to analyze the financial performance of Apple, Inc. and Samsung Electronics Company for the 2018 accounting year. The paper discusses the background information of the two companies, compares the companies' current and debt ratios, profitability and performance ratios, investment and valuation ratios and the non-financial criteria that could be considered when choosing the best investment option between the two companies.

Background information of the two companies

Samsung Electronics Company

Samsung is a company that originated from South Korea back in 1938. The company was founded by Lee Byung-Chul as a manufacturing firm. The company deals in a variety of products like apparel, chemicals, electronic equipment, consumer electronics, and automotive chemicals. However, Samsung is known for its global production and distribution of electronic devices like mobile phones and television sets. The firm also specializes in the delivery of crucial services like financial consultancy services, retail, advertising, and construction. Being a global business, Samsung has nine divisions focusing on various products and services. These divisions include Samsung: Electronics, Insurance, Cheil Worldwide, Fire and Marine, Heavy Industries, Life insurance, SDS, C & T Corporation and Engineering. Currently, the company has its headquarters in South Korea and the key people in the company are Lee Kun-hee the chairman and Lee Jae-Yong the vice chairman (Samsung Electronics Limited, 2019).

Apple Incorporation

Apple Inc. is a publicly traded company in the United States stock exchange market and was founded in 1976 as Apple Computer Company by Steve Jobs, Steve Wozniak, and Ronald Wayne. The firm has over five hundred stores worldwide and is respected for its production of high-quality electronic devices like smartphones. The major subsidiaries of Apple include the Apple Worldwide video and Apple Services. The products sold by the company include iPod, iPhone, Apple TV, and Watch, iWork, and WatchOS while the services that Apple offers to its consumers include App Store, iCloud and Message, App News and iBook store. The key people in the company are Arthur Levinson who is the chairman, Tim Cook who is the Chief Executive Officer, Jony Ive the CDO, Jeff Williams the Chief Operating officer and Luca Maestri, the Chief Finance Officer (Apple Inc. 2019).

Comparison based on current and debt ratios

According to Maynard (2017), the current ratio measures the company's ability to meet its short term financial obligations as and when they fall due while the debt ratio such as debt to equity measures leverage ratio of the company which defines the firm's ability to meet its long term financial obligations in case of insolvency. The current ratio = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$. For Samsung company, the Current Ratio for 2018 was $\frac{174,697,424,000}{69,081,510,000} = 2.53$ while for Apple company, the current ratio = $\frac{131,339,000}{111,886,000} = 1.17$.

On the other hand, the debt to equity ratio for Samsung Company is $\frac{996,935,000}{240,068,993,000} = 0.41\%$ while the Apple, Inc.'s debt to equity ratio is $\frac{93,735,000}{107,147,000} = 87.4\%$.

Analysis

A current ratio exceeding 1 indicates that the firm can meet all the short term financial obligations. Samsung's current ratio of 2.53 implies that for every dollar of short term debt, the company has \$2.53 of assets that can be liquidated to pay up the financial obligations thus the firm is in a favorable position. Apple, Inc.'s current ratio also shows that for every dollar of short term debt, the firm has \$1.17 in the form of current assets which can be liquidated to meet its short term obligations as and when they fall due. However, Samsung's ratio shows that it is in a better position compared to Apple Inc.

The debt-to-equity ratio shows the capital structure of the company and shows the amount that is owed to external creditors (Maynard, 2017). The ratio can be expressed in percentage to show the extent to which the company's capital relies on debt. According to the financial statements of 2018, Samsung had a low debt-to-equity ratio of 0.41% while Apple has a massive 87% of debt-to-equity. The ratio shows that Samsung Company has low leverage and can attract investors while Apple Company has high leverage and may not be favorable for the long term financial returns of the company.

Comparison based on profitability and performance ratios for the years 2016, 2017 and 2018

Maynard (2017) posits that the profitability and performance ratios that can show the financial progress of the two companies over the past three years (2016, 2017 and 2018) are the Return on Assets (ROA) and Return on Equity (ROE). ROA is the ratio measuring the net income that a company's total assets have produced during an accounting period compared to the net income of the total assets during the accounting period. The ratio therefore measures the

efficiency of a firm in asset management. $ROA = \text{Net Income} / \text{Average Total Assets}$. For Samsung company, the 2018 Net Income was KRW 43,890,877,000 while the average Total Assets = $\text{KRW } (339,357,244,000 + 301,752,090,000 + 262,174,324,000) / 3 = 301,094,553,000$. Therefore, the Samsung $ROA = 43,890,877 / 301,094,553 = 14.58\%$

On the other hand, Apple, Inc. has Net Income of \$59,531,000 and the average of total assets over the three years (2016, 2017 and 2018) would be $(365,725,000 + 375,319,000 + 321,686,000) / 3 = \$354,244,000$. Therefore, the ROA for Apple, Inc. = $59,531 / 354,244 = 16.81\%$

Return on Equity (ROE) is the profitability ratio measuring a firm's ability to generate profits from the total shareholders investments and is expressed as a number which can either be more than one or less than one. $ROE = \text{Net Income} / \text{Shareholders equity}$ (Robinson, Henry, Pirie & Broihahn, 2015)

The average ROE over the last three Years for Samsung Company = $\text{Average Income} / \text{Average Shareholders' Equity}$. Average Profit = $(43,890,877,000 + 41,344,569,000 + 22,415,655,000) / 3 = 35,883,701,000$. Average Shareholders Equity = $(240,068,993 + 207,213,416 + 186,424,328) / 3 = 211,235,579,000$. Therefore, Samsung $ROE = 35,883,701 / 211,235,579 = 0.17$

The average ROE over the last three Years for Apple, Inc. = $\text{Average Income} / \text{Average Shareholders' Equity}$. Average income = $(59,531 + 48,351 + 45,687) / 3 = 511,190,000$. Average Shareholders Equity = $(107,147 + 134,047 + 128,249) / 3 = 123,148,000$. Therefore, Apple Inc. $ROE = 4.15$

On the operating performance of the two companies, the fixed asset turnover ratio is used. The ratio measures the ability of a company to produce sales using its machines and equipment. The ratio is calculated as $\text{Net Sales} / \text{Fixed Assets less Accumulated Depreciation}$.

For the financial year ended 31/12/2018, Samsung Company had a fixed asset turnover of $243,771,415 / 164,659,820 = 1.48$ while Apple, Inc. had a fixed asset turnover of $265,595 / 234,386 = 1.13$.

Analysis

A high return to equity ratio shows that the company can use the shareholders' equity efficiently and a high return on assets ratio indicates that the firm can translate the assets into income through a balanced risk-reward approach of investment. Considering that Samsung has a ROA of 14.58% while Apple, Inc. has a ROA of 16.81%, the net conclusion regarding the return on assets is that Apple, Inc. is more efficient in the allocation and management of assets compared to Samsung company. Besides, Apple, Inc. has a higher return on equity of 4.15 compared to Samsung's 0.17 indicating that the former is more efficient in the management of equity capital than the latter.

On the operating performance, Samsung Company generate sales worth 1.48 times more than the book value of its fixed assets while Apple, Inc. has generated sales worth 1.13 times more than the book value of the fixed assets. Overall, Apple, Inc. has better management strategies of the company assets and equity than Samsung Company, but Samsung has better operating performance than Apple, Inc.

**Comparison based on cash flow indicator and investment valuation ratios for the 2018
accounting period**

The cash flow indicator ratio to be used in the comparison is the Dividend Payout ratio while the Investment valuation ratio is the Price Earnings ratio (P/E).

According to Robinson, Henry, Pirie & Broihahn (2015) the dividend payout ratio measures the portion of net income that shareholders have received in the form of dividends. The ratio is calculated as Total Dividends / Net Income.

Samsung Company's dividend ratio for 2018 was $10,193,695 / 43,890,877 = 23.23\%$ while Apple, Inc.'s dividend ratio was $13,712 / 59,531 = 23.03\%$

The Price /Earnings Ratio measures the market value of the forms stock relative to its earnings (Robinson, Henry, Pirie & Broihahn, 2015). The ratio, therefore, shows what the market is willing and able to pay for the company's stock based on the reported earnings. The P/E ratio is calculated as Market Value Price per Share (MPS)/ Earnings per Share (EPS).

Samsung company's P/E ratio = $44.20 / 5.87 = 7.53$; the Apple Inc.'s P/E ratio = $210.52 / 12.16 = 17.31$

Analysis

The consistency of the dividend payout ratio is more important for a company's shareholders compared to the level of the ratio. However, a higher dividend ratio indicates a high return for the investors and would, therefore, be preferred to a lower ratio. Using the calculated figures, Samsung Company has a slight advantage over Apple, Inc. considering that the two firms offer a dividend payout of 23%. However, the P/E ratio goes beyond what the company

pays and measures the expected price per share of the company's shares based on its current earnings. Therefore, Apple, Inc. has a positive prospect because of its high P/E ratio of 17.31 compared to Samsung Company's 7.53.

Choosing the company to invest in

Using the financial criteria which consider the company ratios, I would, as an investor, decide to invest in Apple, Inc. because of four reasons. First, the company has a higher Price Earnings Ratio indicating that my shares would have value in the future and therefore there is less or reduced risk of making losses if I became a shareholder with the company. Besides, a dividend payout of 23% is high enough considering that Apple, Inc. makes net income in millions of dollars. Consequently, I would have high returns in the form of dividends. Secondly, Apple, Inc.'s profitability and operating performance ratios indicate that the firm can turn the fixed assets into sales and Return on equity shows that the firm can earn up to 4.15 times more in sales from the equity from investors which is an indication of the future success of the company. The third reason why I would choose to invest in Apple, Inc. over Samsung Company is the ability of the firm to settle its short term financial obligations as and when they fall due as indicated by the current ratio of 1.17. However, the company has the disadvantage of being highly leveraged because of the significant debt to equity ratio. However, the net positive cash flows demonstrate that the company would be in a position to offset the debt in the nearest future.

The non-financial criteria for choosing between the two companies

Borrowing from Easton, & Sommers (2018), there are five key factors that I would consider before choosing the company to invest in. First, I would consider the governance

structure of the company to ascertain if it is able to handle the shareholders' interests. Secondly, I would consider the value creation strategy of the company with regards to the short and long term goals. For example, I would be interested in knowing if a company diversifies in product promotion strategies to increase sales. The third non-financial factor that I would consider is the social corporate responsibility level of a company. There is a plethora of information justifying that the success of a company depends significantly on its relationship with the shareholders and the Corporate Social responsibility (CSR) can play a role of ensuring that a company has a strong brand and the products are likable in the market. The fourth non-financial factor that I would consider is the business reputation which is protected under the Intellectual Property (IP) and the company's strategy of protecting the IP from competitors in the electronics manufacturing business. The final factor which I would consider is the recruitment procedure and process of a company to ascertain if the staff hired are trained on the emerging issues in the business to ensure that my goal of wealth maximization is protected by all employees.

Conclusion

The essay has done a comparative financial analysis between Samsung Company and Apple, Inc. by explaining the background of the two firms and analyzing the current and debt ratios, profitability, and operating profit ratios, and cash flow indicator and investment valuation ratios. Besides, the essay has explained why, as an investor, I would choose Apple, Inc. Finally, the paper has explained the five key non-financial factors that I would consider when investing in a firm. Using the financial analysis, it is evident that the two firms, Samsung and Apple, Inc. have a positive prospect of growth in the future and are both worthy of financial investment.

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