Financial Health Management Report: Amazon Inc (2020-2022)

This report aims to provide a detailed analysis of Amazon Inc.'s financial health from 2020 to 2022, focusing on key metrics including liquidity, profitability, solvency/debt management, asset utilization and investor/market ratios. Additionally, we will explore the impact of changes in growth rates, main line items on the balance sheet, margins as a percentage of net sales, income tax rate, and capital expenditures on Amazon's financial performance and overall health.

Liquidity

The measures of liquidity that were calculated were the current ratio, quick ratio, cash ratio, defensive interval, inventory days, payable days, receivable days, net trading cycle, working capital and working capital as a percentage of sales. The current ratio and quick ratio declined from 1.05 to 0.94 and 0.86 to 0.72 respectively between 2020 and 2022. This indicates that Amazon is more likely to struggle to meet short-term obligations with its current assets alone. This could result in difficulties in paying off creditors or funding operational needs without relying on external financing. The cash ratio did increase slightly from 0.33 to 0.35 which shows that with cash and cash equivalents, Amazon is in a slightly better position to meet its short-term obligations; further proven by the $17.8 bn increase in cash, cash equivalents and restricted cash seen in 2022 on the Consolidated Statement of Cashflows.

The 29% decrease in defensive interval (from 403 days to 288 days) and negative working capital as a percentage of sales (-1.67%); further indicate a weakened ability for Amazon to cover its operating expenses and short-term liabilities with its current assets. This may signal increased reliance on external financing to sustain operations, potentially impacting financial flexibility and stability. The significant decrease in working capital from $19.3 bn to $-8.6 bn indicates that the firm’s current liabilities have dramatically outpaced its current assets. This is partially due to the 73% decrease in marketable securities held by Amazon, which could be a protective measure taken as a result of market uncertainty. The decreases in working capital as a percentage of sales shows that the increases in current liabilities relative to current assets and has not been justified with a corresponding sufficient raise in sales revenue. The 48% increase in cash and cash equivalents from 2021 to 2022 is reflective of the mentioned reduction in marketable securities and may also indicate that Amazon is aiming to improve its liquidity position in the short-term.

The net trading cycle for Amazon being a negative number of days from 2020-2022 is a very positive sign of the firm’s ability to obtain cash from its customers (reducing its trade receivables) and paying its suppliers (reducing its trade payables) at a faster rate than it has to purchase inventory. This indicates that Amazon is in a favourable liquidity position and is effectively managing its capital to ensure it generates cashflow. The negative days of the net trading cycle has fallen by 24% from 2021 to 2022 and signals, alongside the increases in inventory and receivables days, that the firm has been incurring higher costs in holding inventory and may be exposed to a slightly higher risk of bad debts.

The decline in liquidity ratios and certain main line items on the balance sheet suggests potential challenges for Amazon in managing short-term obligations and maintaining financial flexibility. This could impact the company's ability to seize strategic opportunities or navigate unforeseen market disruptions effectively. However, the cash position and payables days are strong indicators of Amazon’s commitment to paying suppliers quickly and holding cash reserves in a year of financial uncertainty. Amazon should focus on improving its liquidity position by optimizing working capital management, enhancing cash flow generation and exploring alternative financing options. Strengthening relationships with suppliers and implementing cost-saving initiatives could also help mitigate liquidity risks and improve overall financial health.

Profitability & Solvency/Debt Management

Amazon’s gross margin has consistently increased annual by an average of 42% from 2020 to 2022 which is a very strong indicator of Amazon’s ability to increase sales revenue while keeping cost of sales low in comparison. However, a rise in operating expenses as a percentage of net sales could offset profitability gains. The 2022 rate of growth of operating expenses, with an average growth rate of 27% excluding “other operating expenses”, has outpaced the rate of growth of sales revenue and gross profit at 9% and 14% respectively. This explains why operating income saw a 51% drop from 2021 to 2022, where it had been increasing and remained stable for the 3 prior years. Amazon recorded a net loss in 2022 due to the higher operating costs and significantly higher non-operating costs incurred during the year. Consequently, net profit as a percentage of net sales and income tax rate reached dire levels at -0.5% and 0% respectively; suggesting potential challenges in generating profits and managing tax liabilities efficiently. It’s clear that Amazon's profitability has been impacted by changes in operating expenses, revenue mix and external factors affecting business operations. The biggest indicator of this is the 215% decrease in “other income (expense)” which is also seen reconciled on the Consolidated Statement of Cashflows. The fluctuations in EBIT and EBITDA show that interest income/expenses and taxes are not consistent between 2020 to 2022. Both of these margins saw approximately 8% decreases from 2021 to 2022, showing that Amazon’s expenses relating to interest, taxes, depreciation and amortisation totalled to a higher proportion of net sales. The analysis of profitability metrics highlights potential challenges for Amazon in sustaining profit margins and generating consistent earnings. Fluctuations in gross margin, operating expenses, and net profit indicate underlying operational issues or the effects from external factors, e.g. interest rates.

Amazon's ability to manage costs effectively and maintain a healthy gross margin is crucial for sustaining profitability and generating shareholder value. Amazon should prioritize cost management initiatives, revenue diversification and tax optimization efforts to improve profitability and enhance shareholder returns. Implementing efficiency improvements and monitoring key performance indicators could help mitigate profitability risks and support long-term financial sustainability.

Amazon’s debt to equity and debt to total assets ratios have slightly decreased from 2.44 to 2.17 and 0.71 to 0.68 respectively between 2020 and 2022. Its ratio for long-term debt to capital has remained stable over this period which is a positive sign for the firm’s solvency and ability to manage its long-term debt. Declines in the debt coverage ratio (from 0.29 to 0.15 across the 3 year period) and increases in operating lease liabilities could indicate challenges for Amazon in covering debt obligations with available cash flow. This may impact the company's ability to meet financial commitments and maintain creditor confidence. Changes in long-term lease liabilities and other long-term liabilities provide insights into Amazon's long-term financial obligations and debt management strategies. Fluctuations in these metrics could impact debt service capacity and overall solvency. The times interest earned has seen a dramatic decrease from 4.74 to -0.43 from 2021 to 2022. This means that Amazon’s ability to pay the interest on its business debts using its operating income is severely hindered with the $-4.6 bn EBIT not being able to cover any of the interest payments totalling $10.6 bn. Amazon’s solvency was dramatically weakened from its position in 2021 when it had more than enough cashflow to continue to invest in the business; however, in 2022 the firm did not generate enough income from its operating activities to be free to operate outside the constraints of its debts.

Amazon’s free cashflow to equity (FCFE) and FCFE per share have fallen significantly from 2020 to 2022 from $24.8 bn to $-1.2 bn and 2.43 to -0.12 respectively. This indicates a dramatic drop in cash available to shareholders after the payment of expenses, debts and reinvestments. From a valuation perspective, this is a poor sign of Amazon’s financial health and represents a higher risk for investment by equity shareholders than in 2020. Since Amazon has not been issuing dividends from 2020 to 2022, using FCFE is favourable for valuing the firm and assessing financial stresses experienced by the firm.

The analysis of solvency and debt management metrics highlights potential risks for Amazon in managing debt levels and servicing financial obligations. The decline in debt coverage ratios suggest challenges in maintaining financial stability and meeting creditor expectations. Managing debt levels effectively and maintaining a balanced capital structure is essential for safeguarding solvency and financial stability. Amazon should focus on refinancing opportunities and improving cash flow generation to strengthen solvency and debt service capacity. Developing a comprehensive debt management strategy and maintaining open communication with creditors are critical for mitigating solvency risks and preserving financial health.

Asset Utilisation & Investor/Market Ratios

The turnover ratios for total assets, fixed assets and inventory all decreased between 2020 and 2022 by 18%, 29% and 18% respectively. Decreases in total asset turnover and fixed asset turnover ratios indicate potential inefficiencies in utilizing assets to generate revenue. Amazon's ability to optimize asset utilization is crucial for maximizing operational efficiency and profitability. A decline in inventory turnover as a percentage of sales represent weaknesses in Amazon's working capital management and cash flow generation. However, the fact that the firm has managed to raise its gross profit margin whilst the inventory turnover fell reflects the beneficial change in revenue mix implemented by the firm. The levels of capex as a percentage of sales and fixed assets have stayed relatively the same over the 3 year period, indicating that the infrastructure investments being made by Amazon are in line with its financial performance and position. The considerable decrease in return on assets from 9% to -0.62% between 2021 and 2022 is a sign of weakness for Amazon’s profitability. This indicates that Amazon’s management has become far less efficient in generating profit from the total assets on the balance sheet. It’s clear that Amazon has utilised more assets in generating sales in 2022, seen from the 58% increase in cash used in purchasing property and equipment; however, the operating loss is an indicator that this investment has not yet been effective in ensuring overall profitability.

The analysis of asset utilization metrics underscores the importance of efficient resource allocation, inventory management and investment decisions for Amazon's financial performance. Decreases in asset turnover ratios and fluctuations in capital expenditures could impact operational efficiency and long-term competitiveness. Managing asset growth effectively and aligning capital expenditures with strategic objectives is critical for enhancing asset utilization and driving long-term value creation. Amazon should focus on optimizing inventory management processes, enhancing capital expenditure planning, and aligning asset growth with revenue opportunities. Leveraging data analytics and technology-driven solutions could help identify inefficiencies and improve asset utilization across the organization.

Changes in the price to equity ratio and earnings per share reflect investor sentiment and market expectations regarding Amazon's future growth prospects and profitability. The significant decreases in both measures were 1285% and 108% respectively, resulting in negative values for 2022. The 2022 calculated earnings per share value of $-0.27 indicates that for every common share outstanding, Amazon is making a loss of $0.27 which is a signification weakness from a profitability perspective. However, this in and of itself does not necessarily mean that the firm is not experiencing growth and making investments. The 2022 calculated price to equity ratio of -609.58 when compared to the historical values for the period of 40.16 and 51.45 for 2020 and 2021 respectively; shows that Amazon’s relative valuation and financial health has fallen dramatically. Furthermore, a P/E ratio this low could indicate that Amazon’s stock is quite undervalued and the market value per share could soar higher as the firm shifts its revenue mix more towards services rather than products. In order to drive shareholder value, Amazon must maintain a favourable valuation and deliver sustained strong earnings performances.

The book value per share (BVPS) and price to book value increased from 9.16 and 9.17 to 14.33 and 11.36 respectively between 2020 and 2022. The BVPS increase means that the difference between Amazon’s total assets and liabilities is increasing; thus putting the firm in a stronger position to generate cashflow and deliver reliably on its financial obligations. The increase in price to book value shows us that Amazon’s market capitalisation increased relative to its book value from 2020 to 2022, reflecting positive sentiment from market participants. Enterprise value (EV) and enterprise value to EBITDA increased from 2020 to 2022 by 84% and 149% respectively. This represents an increase in the total value of Amazon while taking into account the total debt and cash on the balance sheet. The higher increase in EV to EBITDA stems from the fact that EBITDA decreased by 26% during this period. The gap between Amazon’s profitability and total value has thus widened, further compounding on the notion that the firm is growing but has recorded a net loss in 2022.

A negative rate of return was calculated for return on equity (ROE = -1.86%), return on capital employed (ROCE = -1.48%) and return on assets (ROA = -0.62%) in 2022. The ROE for 2022 represented a 108% decrease from 2020 and indicates that Amazon’s management are not efficiently generating income and growth using its equity financing. Thus the profitability of the firm in relation to the shareholders’ equity is in a weak position, which could discourage further investment. The ROCE for 2022 represented a 111% decrease from 2020 and indicates that Amazon’s management are inefficient in their utilisation of capital in turning a profit. This measure includes non-current liabilities in addition to shareholders’ equity and so is useful for a company like Amazon; where its non-current liabilities have been rising faster than current liabilities over the 3 year period. The ROA for 2022 represented a 108% decrease from 2020 and indicates that Amazon has been inefficient in its ability to manage its balance sheet in order to generate profits. Reviewing the investing activities on the Cashflow Statement, it’s clear that in 2022 the firm has been adjusting its balance of assets, by significantly reducing the purchase of marketable securities and increasing acquisitions. Amazon will need to monitor the usage of each asset class and assess how best to generate profits with their new revenue mix and more efficiently manage its balance sheet.

Amazon has not been paying out dividends for this 3 year period (2020-2022) and as such the dividend payout ratio, dividend per share and dividend yield were determined to be nil. Reinvesting the cash that would be paid out in dividends into the business is Amazon’s current approach in order to maximise profits and enable growth. The share price has risen greatly by 94% from $84 per share in 2020 to $162.85 per share in 2022. This growth is positive for investors and counteracts the possible loss of confidence that could arise from Amazon choosing not to issue dividends.

Generating sustainable returns for shareholders and maintaining market confidence are critical for sustaining long-term growth. The analysis of investor/market ratios underscores the importance of maintaining investor confidence and delivering value to shareholders. The changes in valuation metrics and profitability ratios reflect market dynamics and investor expectations regarding Amazon's performance and growth potential. Amazon should prioritize transparency, communication and alignment with investor expectations to support market confidence and shareholder value creation. Delivering consistent earnings growth, managing capital allocation effectively and executing strategic initiatives are critical for sustaining long-term investor trust and market leadership.

In conclusion, the comprehensive analysis of Amazon Inc.'s financial health from 2020 to 2022 provides valuable insights into the company's performance across key dimensions. For the 2020-2022 period, Amazon’s biggest strengths are its liquidity and solvency/debt management, with its positive metrics including: cash ratio, net trading cycle, debt to equity, debt to total assets, long-term debt to capital, book value per share, price to book value, enterprise value and enterprise value to EBITDA. However, this analysis has highlighted potential challenges and areas for improvement in profitability, investor/market ratios and asset utilisation; with the metrics to improve including: current ratio, quick ratio, defensive interval, working capital, working capital as a percentage of sales, operating profit, net profit, EBIT(DA) margins, times interest earned, FCFE, FCFE per share, asset & inventory turnover ratios, price to equity, earnings per share, return on equity, return on capital employed and return on assets. By addressing liquidity constraints, enhancing profitability, managing debt levels prudently, optimizing asset utilization and fostering investor confidence, Amazon can strengthen its financial resilience and position itself for sustained growth and value creation in the current market environment.