**Management Report for Amazon.com, Inc.**

**Financial Health Analysis: 2021-2022**

**Liquidity Analysis:**

Amazon's liquidity position has exhibited a noticeable decline over the past two fiscal years. Both the current and quick ratios have decreased annually since 2020, with the current ratio dropping below 1 in 2022. This implies that Amazon would face challenges meeting short-term obligations solely through liquidating its assets. The defensive interval, a measure of the company's ability to operate without external capital, declined by almost 30 days to 116 days in 2022, signalling a reduction in operational flexibility. Although payable and receivable days have extended, indicating a slower payment cycle, a positive note is the significant improvement in inventory days, resulting in an enhanced net trading cycle. However, the working capital as a percentage of sales has turned negative due to a decline in current assets and an increase in current liabilities. Overall, Amazon's liquidity has weakened compared to recent years.

The Current ratio is greater than 1 indicating the short-term asset’s ability to meet short term liabilities. Quick and Cash ratios above 0.5 which also indicates that the company can meet more than 50% of its short-term liabilities with its cash in hand. The decline in current ratio was mainly to be attributed to a reduction of marketable securities (following the sale of the company’s stake in Rivian).

As an online marketplace where thousands of vendors are hosted on site, Amazon’s payable days is typically higher than other companies as it is part of its 90-day credit policy. As a result of Amazon’s nature of business, its payable balances are higher than its inventories and receivables where it holds inventory on behalf of its vendors. Therefore, working capital is negative and so is the trading cycle. On a year over year basis the number has worsened, but can be supported with the argument that Amazon has started its own fulfilment services and is a fast growing company.

Operating with a negative Trading Cycle became a source of cash for the company, instead of being a cost for it. However, it can be observed that the Trading Cycle days have reduced over the years indicating that the number of days that they can hold on to the cash has reduced.

**Profitability Assessment:**

Amazon's gross margin has increased, reflecting a higher allocation of revenue toward operating expenses. The EBITDA margin has decreased, indicating rising operating expenses and reduced earnings as a percentage of revenue. The EBIT margin is less than half of previous years, highlighting a current inefficiency in profit generation from sales. The net margin is negative, signalling high costs and a dependency on external sources for investment. This can be attributed to the impact of the current macroeconomic environment, marked by increased costs and higher interest rates affecting profitability.

It is notable that Amazon’s Technology & content and Sales & marketing have seen sharp increases, indicating the heavy spend on AWS and Prime Video content. While the e-commerce segment is seen to be normalizing post the Covid-19 boom, sales reflect the increasing global inflation levels. The high portion of D&A is reflected in the higher EBITDA margin compared to decreasing EBIT margin.

**Solvency Evaluation:**

Solvency metrics reveal Amazon's stable financial position. While the debt-to-equity ratio has risen annually, it remains below 1, indicating a conservative financing approach with more reliance on equity. The debt-to-assets ratio has increased, but Amazon remains a low-risk business. Long-term debt to capital ratio and times interest earned indicate overall stability and a low risk of default. Debt coverage, though negative, has improved significantly in 2022. FCFE per share has increased, suggesting potential future growth in earnings and share value.

Amazon’s long-term liabilities have been increasing over the years as the company has increased its Financial lease commitments to facilitate the number of new fulfilment centres opened over the last year. Although the long-term debt remain rather steady, financial lease commitments have dramatically increased which has increased the debt service burden as well. However, the company has adequate levels of interest coverage and free cash flow indicating its financial health. However, the increase in the debt level would also mean that the company’s borrowing capacity in future is strained where it might have to pay higher interests to secure more debt.

**Asset Utilization:**

Amazon's asset turnover has remained consistent, indicating efficient sales generation with existing assets. Fixed asset turnover is healthy, and although inventory turnover has decreased slightly, it remains high, supported by a steady increase in net sales. Return on assets is generally low, turning negative in 2022, reflecting a net loss for the year.

Amazon has a large portion of goodwill in its asset base, where the Fixed asset turnover is almost three times higher than the total asset turnover. The goodwill and intangibles are manly as a result of acquisitions in addition to the increased R&D spending on AWS which we will have to closely watch for future profitability.

**Investor and Market Ratios:**

Amazon's Price to Equity ratio decreased significantly in 2022, with a negative P/E reflecting 2022’s losses. Negative Earnings Per Share indicates a loss, but increased liabilities, assets, and net sales suggest significant inward investment. Prive to Book Value, while lower, still indicates a premium valuation, yet a negative Return on Equity implies shareholder losses. Return on Capital Employed has decreased markedly, signalling low profitability in 2022. The historically high EV/EBITDA ratio dropped by approximately 25%, signalling a potential investment opportunity before profitability stabilizes.

ROE, ROA and ROCE all are within the health territory, however, have declined slightly compared to previous year. Furthermore, given Amazon’s valuations, one would expect the ratios to be better as there are many other smaller companies with better returns than Amazon, however, it is notable that these valuations are backed by Amazon’s expansion.

**Conclusion:**

Amazon has strategically navigated the challenges posed by the current macroeconomic landscape through decisive operational adjustments. The company's proactive measures include the cessation of certain ventures and substantial investments in fortifying its fulfilment network to accommodate increasingly heightened sales demands. Simultaneously, Amazon has undertaken substantial initiatives to enhance operational efficiency, channelling resources into growth frontiers such as Amazon Web Services, as well as targeted market segments like Grocery, Business, and Health.

Furthermore, the strategic emphasis on emerging technologies, specifically the robust investments in Large Language Models and Generative AI, underscores Amazon's commitment to future growth, operational refinement, and an enhanced customer experience. While these initiatives have incurred short-term costs and increased reliance on external financing, their collective impact positions Amazon for a notable upswing in profitability over the long term. The judicious execution of these pivotal decisions reflects Amazon's resilience in adapting to dynamic market conditions and fortifying its financial health for sustained success.

Additional Sources:

Amazon 2022 Letter to Shareholders: https://s2.q4cdn.com/299287126/files/doc\_financials/2023/ar/2022-Shareholder-Letter.pdf