**Management Report and Analysis of Amazon.com, Inc. Financial Health for Financial Years’ 2022 and 2021**

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Amazon.com, Inc. is a global Tech Firm specialising in e-commerce, cloud computing, e-advertising, digital streaming, and artificial intelligence. Selling a variety of goods and services to customers is Amazon's main source of revenue. It sells goods and materials that it has bought for resale as well as items from third-party sellers through its storefronts. Additionally, it creates media content and sells and produces electrical gadgets.

**Liquidity Position**

Liquidity ratios measure a company's ability to meet short-term obligations and provide insight into its financial health. Amazon's liquidity position shows mixed trends. While the defensive interval and net trading cycle have improved, the current ratio and cash ratio have decreased, raising concerns about its ability to meet short-term obligations.

The current ratio which measures a company's short-term liquidity had 0.94 current ratio in 2022, which indicates that the company has $0.94 in current assets for every dollar of current liabilities. However, this declined from 1.14 in 2021, suggesting a potential decrease in the company's ability to meet its short-term obligations. Also, Amazon’s cash ratio – measuring its ability to pay off its current liabilities using only its cash and cash equivalents improved in 2022 to 0.35 compared to 0.26 in 2021. Despite the slight improvement, it still indicates that Amazon relies heavily on non-cash current assets to meet its short-term obligations. Amazon’s defensive interval/operating cycle (which measures the number of days a company can operate using its cash reserves without any additional cash inflows) in 2022 was 76 days compared to 106 days in 2021. The lower defensive interval in 2022 suggests Amazon’s ability to cover expenses with its existing cash has improved, indicating better short-term liquidity. Its Net Trading Cycle and receivable days, thus, the time it takes for it to convert its inventory and receivables into cash has decreased to 31 days in 2022 from 41 days in 2021 and from 27 to 22 in 2022 for receivable days. The Net Trading Cycle reduction indicates a more efficient cash conversion cycle while that of receivable days implies that Amazon is collecting its receivables faster, enhancing its cash flow and liquidity position.

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 Analysis**

Profitability margins measure a company's ability to generate profits relative to its revenue and costs. Amazon's profitability analysis reveals mixed trends as well. Whereas the EBITDA margin, EBIT margin, and net margin experienced significant declines, the gross margin improved slightly.

Gross Margin is the percentage of revenue that exceeds the cost of goods sold (COGS). In 2022, the gross margin was 43.81%, a slight improvement from 42.03% in 2021. A higher gross margin indicates that Amazon is effectively managing its production costs and generating more profit from each sale. EBITDA Margin on the hand measures earnings before interest, taxes, depreciation, and amortization as a percentage of revenue. The 2022 financial year saw the EBITDA margin decreased to 10.84% from 12.86% in 2021. This decline suggests that Amazon’s operating expenses and non-operating costs may have increased, affecting its profitability. The Net Margin of a company also shows the percentage of revenue that translates into net income after all expenses, including taxes. Amazon’s net margin in 2022 turned negative at -0.53% from 7.10% in 2021. The negative net margin means that expenses exceeded its revenue, resulting in a loss. It can be observed from the Income Statement that in 2022, every single expense item grew accounting for a lower operating income, thus, the total operating expenses constituted almost 98% of Total Net Sales. This could be attributable to macro pressures such as supply chain woes, bloated cost structures, inflation, stiff competition from rival products and services as well as currency volatility (JP Morgan, 2023). JP Morgan noted that ‘in November 2022, the Internet companies were down by 53% on average year-to-date, and by over 40% weighted by market capitalisation’.

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.

**Solvency Analysis**

Solvency ratios assess a company's ability to meet its long-term debt obligations and its overall financial stability. Amazon’s solvency ratios experienced deteriorations, indicating potential financial challenges. The higher soaring ratios and declining debt coverage ratios may raise concerns about Amazon’s ability to meet its long-term debt obligations.

A Debt-to-Equity Ratio compares a company's total debt to its shareholders' equity, indicating its financial leverage. Amazon’s D/E ratio increased to 2.08 in 2022 from 1.96 in 2021. A higher D/E ratio may suggest increased financial risk and dependence on debt financing. However, financial leverage could also be magnified, in certain instances, as debt to equity increases. Also, the Debt to Total Assets Ratio which shows the proportion of a company’s total assets financed by debt rose in 2022 to 0.66 from 0.64 in 2021 indicating that Amazon relied more on debt financing to fund its assets, which could increase its financial risk. In addition, the Long-Term Debt to Capital Ratio of Amazon saw an increase to 0.35 in 2022 from 0.33 in 2021. The higher long-term debt to capital ratio thus, the measurement of the portion of Amazon’s capital structure financed by long-term debt, indicates increased leverage, hence could amplify the company’s financial risks. Debt Coverage Ratio evaluates a company's ability to cover its debt obligations through its operating income. In 2022, the debt coverage ratio decreased to 9.74 from 15.65 in 2021. The declining debt coverage ratio could imply that the company's operating income is insufficient to cover its debt payments. The Times Interest Earned Ratio on the other hand assesses the company's ability to meet its interest expenses with its operating income. Amazon’s time interest earned ratio dropped to 3.12 in 2022 from 34.74 in 2021. Such a significant decline could indicate that the company's profitability and cash flow have weakened (as evident from the Income Statement and Profitability Analysis above). This would make it more challenging for Amazon to service its interest payments.

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 Utilisation Analysis**

Asset utilisation ratios measure how efficiently a firm uses its resources to generate revenue and profits. Amazon’s asset utilisation analysis reveals diminishing productivity across several of the firm’s operational areas. Lower ratios for total asset turnover (dropped from 1.27 in 2021 to 1.16 in 2022), fixed asset turnover (dropping from 2.10 in 2021 to 1.79 in 2022), and inventory turnover (which also dropped from 9.65 in 2021 to 8.62 in 2022) indicate that the company may be having trouble utilising its assets effectively to generate revenue and profits. For instance, the decreased fixed asset turnover could mean that Amazon is not making as much use of its fixed assets to drive sales whereas the decreased inventory turnover could be a sign that it is having trouble selling its goods or controlling its inventory levels. The return on assets ratio which measures the efficiency with which a business makes profit from all its assets decreased to -0.59% in 2022 from a value of 7.93% in 2021. The low ROA could be a symptom of financial trouble for Amazon because it shows that the company’s net income is not enough to cover its asset base. Basically, Amazon’s problems with profitability are indicated by the negative return on assets in 2022.

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.

**Market Ratios Analysis**

Market ratios give an investor's perspective on how the market values a company's shares and its financial performance. The market ratios analysis reveals mixed trends. Along with the negative ROE, the dropping P/B ratio and ROCE could be signs of declining investor confidence and difficulties with profitability.

A company’s profitability in relation to shareholders’ equity is gauged by return on equity (ROE). Amazon’s ROE turned negative in 2022 at -1.91%, down from 28.81% in 2021. Investors ought to be concerned when the ROE is negative since it’s an indication that the company’s net income is insufficient to generate a positive return on shareholders’ equity. Also, the Price to Book (P/B) value, (measuring the value investors are prepared to pay for each dollar of book value by comparing the market price per share to the book value per share) decreased significantly from 12.42 in 2021 to 5.86 in 2022 suggesting that investors are currently placing a lesser premium on the stock of Amazon compared to its book value. The enterprise value (which is the theoretical takeover cost of Amazon) dropped from $1,729,073 in 2021 to $869,138 in 2022. Changes in the company’s market capitalisation, debt levels, or other aspects affecting its overall valuation may have an impact on the decline in enterprise value. Again, a Return on Capital Employed (ROCE), which considers both debt and equity, measures a company’s profitability in relation to its total capital employed. Amazon’s ROCE dropped from 13.15% in 2021 to 1.52% in 2022. The decline in ROCE indicates that Amazon’s profitability in relation to its total capital has decreased, possibly due to lower earnings or an increase in capital employed.

In conclusion, the Profitability ratios indicate potential challenges in managing operating expenses and generating net income particularly in 2022. Amazon itself, in its 2020 financial statements report (Page 23) acknowledged that *“Macroeconomic factors, including inflation, increased interest rates, significant capital market volatility, the prolonged COVID-19 pandemic, global supply chain constraints, and global economic and geopolitical developments, have direct and indirect impacts on our results of operations that are difficult to isolate and quantify. These factors contributed to increases in our operating costs during 2022, particularly across our North America and International segments”.*

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.

**References**

JP Morgan (2023). The Future of Big Tech: What challenges and opportunities lie ahead for Big Tech? J.P. Morgan Research explores the 2023 outlook. <https://www.jpmorgan.com/insights/research/future-of-big-tech>