A Brief Financial Analysis Of Essay, Research Paper

Arrow Electronics Inc. started as a small electronics distribution company that has recently claimed the number one position as leader in the electronics distribution industry. Headquartered in Melville, New York, Arrow Electronics Inc. currently has 225 sales facilities and 19 distribution centers in 37 countries worldwide. The bulk of products that Arrow sells can be condensed into two categories: electronics components and computer products. Arrow has reached the top half of the Fortune 500 company ranking and plans to stay there. Their distribution network spans across three major electronics markets: North America, Europe, and Asia/Pacific region.

Several factors have influenced Arrow s industry leadership. Through strategic acquisitions and steady growth, Arrow has climbed to the top of the market.

The philosophy that has enabled Arrow to become the worldwide leader in electronics distribution is teamwork. The teamwork philosophy can be summed up in five objectives:

1. Maintain our strategic vision and the courage to preserve

2. Offer the most comprehensive selection of world-class quality product lines

3. Create the most innovative distribution techniques and value added capabilities

4. Provide easy, worldwide access to our products and services

5. Develop the most knowledgeable, motivated, and well-trained employees

Arrow feels that, more than anything, the electronics business is a service industry.

Arrow s latest acquisition was of MOCA, a leading reseller of Sun Microsystems in North America. This acquisition became complete on Oct. 30, 2000. MOCA, with 1999 revenue of nearly $1 billion, is focused mainly on selling Sun enterprise software, storage area networks, operating systems, and professional services. Arrow s most substantial competitor is Mitsubishi Electric and Electronics USA, Inc. Mitsubishi Electronics is ranked in Forbes International 800 as number 50, with revenues in excess of $35 billion. Mitsubishi Electronics is an American division of the parent company Mitsubishi Co. that owns a substantial amount of subsidiaries in a wide range of industries.

Short-term liquidity is an organization s ability to meet current payments as they become due. Liquidity is also a measure of how quickly an item can be converted into cash. The Current Ratio is the most widely used and renowned liquidity ratio. It s simply the currents assets divided by the current liabilities. The Cash Ratio consists of cash divided by current liabilities. The Interval Measure is a useful ratio that can break down current assets into a daily projection of liquidity. Interval Measure is comprised of current assets divided by average daily operating costs. The Current Ratio shows that Arrow is a fairly healthy company. For the three years in question, Arrow s current ratio has been greater than 1. This indicates that the company has positive net working capital. The Cash Ratio illustrates that Arrow has a very low amount of cash on hand. Arrow has greater liabilities than it does cash or cash equivalencies. If Arrow needed to know how many days its current assets would last during a financially dry period, the Interval Measure would be beneficial. The ratio would illustrate to the analysts whether or not Arrow had enough current cash to cover any future debts. Arrow s Current Ratio for 1999 was 2.4. Arrow has had over twice as many current assets as current liabilities. The Cash Ratio for 1997 and 1998 were .12 and .14 respectively, indicating that Arrow didn t have a very large amount of cash. The Cash Ratio fell dramatically from .14 in 1998 to .034 in 1999. The cash on hand decreased in 1999 by nearly 30%. This is due to the large use of cash towards investing activities in amount of $543.3 million. This includes the acquisitions of the Panamericana Comercial Importadora Co., the Spoerle Electronic and Support Net, Inc., the Scientific and Business Minicomputers, Inc., as well as various Internet investments and capital expenditures. Arrow has had a fair amount of operating income associated with mergers and acquisitions. The Interval Measure indicates that Arrow s assets would last 1,329 days in an economic downturn. In analyzing Arrow s benchmark corporation- Mitsubishi Electronics, the findings were slightly different.

Their Current ratios for 1997, 1998, and 1999 were closer to 1 than Arrow s. Perhaps Mitsubishi is more conservative in purchasing assets than Arrow, or perhaps Mitsubishi is more liberal in accumulating debt. The Cash Ratio for Mitsubishi was noticeably larger than Arrow s. Mitsubishi has had much more cash to deal with than Arrow. In the eyes of a short-term creditor, Mitsubishi would be a bit more appealing than Arrow. Mitsubishi has a higher average daily operating cost, and therefore a lower Interval Measure even though it has far greater current assets. Long-term solvency represents a corporation s ability to generate enough cash to pay off long-term debts as they mature. There are several equations that comprise long-term solvency or what is also called financial leverage. The most important debt that a company has is payment to its investors, or in other words payment of equity. For 1999 Arrow Electronics had $0.61 of total debt to investors for every $1.00 in total assets or 61% debt. The total debt ratio has increased over a three-year span by approximately 5%. Arrow s total debt ratio seems quite high, but in comparison to the benchmark, Mitsubishi Electric Co., it s average. Mitsubishi has a very high total debt ratio of 87% or $0.87of debt to every $1.00 of assets. They certainly have much more debt to stockholders than they do assets. The long-term debt ratio is an equation that comprises long-term debt and total equity. The total equity contained 102,950,640 of common stock at par value of $1.00 for 1998 and 1999, and retained earnings of over $968 million. Mitsubishi on the other hand had a total equity comprised of 8 billion shares, over 2 billion that were issued and retained earnings of $2.7 billion. The cash coverage ratio describes Arrow s ability to generate cash from operations generally used to meet financial responsibilities. The cash coverage ratio incorporates earnings before interest and tax, depreciation, and interest. In 1999, Arrow had a cash coverage ratio of 2.76, which has decreased by nearly 3 units for each year analyzed. This shows that Arrow has had increasingly less cash available each year to pay its debts. This is mostly due to a decrease in earnings before income tax over the three-year period. Interest expense has also increased over the period.

Asset Management measures represent the effectiveness to which a company utilizes its assets to generate revenue. There are several accounting ratios that divulge Arrow s asset utilization efficiency. Inventory Turnover illustrates the number of times the inventory was consumed or turned over in a given time period. Receivables Turnover indicates how quickly a company can collect on the sales of the inventory. Net Working Capital Turnover illustrates the effectiveness of working capital in relation to sales. The Inventory Turnover tells us that in 1997 and 1998, the inventory turned over five times in each year. In 1999 however, inventory only turned over 1.3 times. For 1999, cost of goods sold was substantially less than 1997 and 1998. Inventory actually increased though for 1999. This indicates why the inventory turnover ratio was less in 1999.

The Receivables Turnover for 1999 was 5.7, which tells us that what Arrow actually received from Inventory sold was 5.7 times less than Sales. The Receivables Turnover reminds us not to assume that a high sales figure insinuates that current assets will be equally high. In many cases consumers will not pay upfront and the money generated from sales doesn t materialize the moment the sale is made. For 1999, Arrow s Sales were nearly six times greater than the amount it invested in itself to generate those sales. This is the defining feature of the Net Working Capital Ratio: how much work comes out of the working capital. In Arrow s case, a significant amount does. Arrow s management seems to make sound decisions to ensure that they are using there capital wisely, which sends a signal of competence to investors. The Inventory Turnover of Mitsubishi was far lower than Arrow s due to a much greater cost of goods sold. Even though Mitsubishi has more inventory Arrow has the better turnover. Arrow s Receivables Turnover is much greater than Mitsubishi s as well. Mitsubishi has greater sales than Arrow, but it also has greater accounts receivables. Mitsubishi isn t in a poor position however, the company just has slower turnover. Net Working Capital Turnover on the other hand is greater than Arrow s for 1999 and 1997. In 1998, current liabilities exceeded current assets and caused a negative denominator. This in turn caused a negative NWC Turnover. The fact that Mitsubishi had negative working capital is dangerous in that it caused 1998 s sales to decrease by 8%. It also causes concern as to why they borrowed more capital than they had to pay off. The liabilities were greater than the current assets.

Profitability is the most widely analyzed financial performance indicator in the business world. The Profitability Ratio measures how effectively the firm uses its assets and manages its operations. The Profit Margin Ratio is an equation that takes net income and divides it by sales. It illustrates what percent of sales is actual profit. A high profit margin is usually most desirable. Return on Assets is a ratio that illustrates the profit per dollar of assets. It shows a percent of every dollar of assets that is profit. Return on Equity is a measure of the shareholder s return. The greater the return on Equity, the happier the shareholders are. The Profit Margin for Arrow Electronics in all three years is very low. The sales figures are high enough, but the net income is very low in comparison. The Drop in 1999 Net Income from $145 million to $124 million in 1998 was due to an increase in operating income. This was primarily due to the acquisition of two subsidiaries: Richey Electronics and Bell Industries Electronics, in the amount $24 million. The Profit Margin ratio indicates that for every dollar of sales Arrow had in 1999, there is .013 cents of profit. The 1999 Profit Margin Ratio also reflects an increase in interest expense of approximately $30 million from borrowing funds for acquisition and investments in working capital. The borrowing of funds for acquisition, and the purchase of common stock caused Arrow s 1997 increase in interest expense. The Return on Assets for 1997-1999 is just as low. The Ratios don t even break 1.0%. Here the same problem is evident. Net Income is far less than Total Assets. The Return on Equity is slightly better for 1999 than the previous two years, but not by that much. This is due to an increase in net income, and a smaller Total Equity figure of $4.5 billion. Over the three years in question, the ROE has gotten progressively smaller, due the drop in net income. In comparison, Mitsubishi s Profitability Ratios were tainted severely from the curse of a 1999 negative net income. Even though sales increased for the year, total expenses exceeded total income substantially. The most striking increase in expenses came from a restructuring charge of $624 million, and an exchange loss of $129 million. The restructuring charge is unclear, but most likely is from the closing of certain plants and the income compensation packages from laying workers off. The exchange loss presents a very interesting glance into the negative effects of the pinnacle of our new 1999 economy. In 1999, the value of the Dollar soared to new heights surpassing even our benchmark Japanese economy. The raw strength of the dollar perhaps caused Mitsubishi to sell certain inventory at a discount, and also affected the exchange of Yen assets to Dollar assets. This discount produced what appeared to be a drop in profit in U.S. Dollars. But in reality it merely reflects the de-valuation of the Yen to the Dollar in the fiscal year of 1999, which in retrospect was distinctly greater than any year previously and to date.

Market Value Measures represent the price investors buy and sell shares of stock on the open trade market. Market Value illustrates a company s current financial position and prospective future position. The Price Per Earnings Ratio is the price of one share divided by the earnings of one share. The Market to Book ratio is the market value of one share divided by the book value of one share or the historical cost. Typically a value greater than one indicates that the company has increased stock value. Arrow s 1999 PE ratio of 20.23 is right in line with the current national norm of 21. For the three years in question: 1999, 98, and 97, Arrow s EPS has been greater than one signifying an increase in stock value. Mitsubishi Electronics had a very high 1999 PE ratio of 89.2. One might interpolate this high PE ratio to mean that Mitsubishi has significant prospects for growth. But in analyzing the ratio it is clear that the EPS value of .11 is extremely low. This low value is what caused the PE ratio to be so high. Arrow s Market-to-Book ratios for 1997- 1999 were just 2 which is slightly larger than the historical norm for blue-chip companies of 1.7. Again Mitsubishi s figures seem pleasantly large, but only due to a low book value of .65 to .72.

Arrow s average current ratio of 2.4 showed a positive Net Present Value. Mitsubishi also has had a positive Net Present Value. But Arrow s current ratio is twice as high, signaling greater value to investors. Arrow has had low amounts of cash on hand to pay off current liabilities and short-term debt. Mitsubishi has had relatively more cash and cash equivalencies to pay off current debt. Arrow s assets would last longer than Mitsubishi s in an economic downturn. Arrow s Total Debt ratio is smaller than Mitsubishi s due to more relative equity, indicating that Arrow s dividend yields are greater. Arrow s Long-Term debt ratio is smaller than Mitsubishi s due to a larger total equity figure of 1,550,529 than long-term debt figure of 1,533,421. Mitsubishi has been able to generate far more cash from operations in 1999 than Arrow. Mitsubishi on average has turned over its inventory at a much higher rate than Arrow. But Arrow has collected receivables at a faster rate of around 6 compared to Mitsubishi s 4. In 1999, Mitsubishi used working capital more effectively than Arrow by about 4%. Arrow on average has had a higher Profit Margin than Mitsubishi as well as a higher Return on Assets and Equity indicating that Arrow is all around more profitable. Arrow Electronics has a far greater EPS, and overall market value. Although Mitsubishi deals with far greater amounts of capital than Arrow, Arrow is the more solid investment. The bulk of Arrow s financial ratios seem to be greater than the national averages and much more stable than Mitsubishi s.