Trend Analysis and Comparing Companies, Part 2

The standard method for reporting the financial performance of companies is on a total dollar basis. Looking at this raw data, however, it is sometimes difficult to discern trends in a company's performance or to compare companies—especially those that differ significantly in size (sales). To aid in this process, *Stock Investor Pro* provides alternate means of examining financial statement data. In last month's *Stock Investor News*, we discussed making quarter-over-quarter and per-share comparisons. In this installment of *Stock Investor News*, we continue the discussion of trend analysis by examining annual percentage change figures and common-size financial statements.

Annual Percentage Change

Just as quarter-on-quarter percentage change data is provided for the quarterly financials, annual percentage change data is available on the Percent Change subtab of the Fin - Ann'l tab of the Stock Notebook. Seven years of income statement, cash flow and balance sheet data are provided. When looking at several years of financial data, a good way to identify trends is to examine the changes in the data over time. These changes are presented in the form of percent change from year-to-year, as shown in Microsoft Corp.'s (MSFT) income statement with the annual percent change subtab selected.

Seeking Common Ground

Common-size financials are useful when analyzing trends in a company or when comparing several companies, especially if they are of differing sizes. For common-size balance sheet and income statements, the goal is to create relative figures using a scaling factor. For the balance sheet, the scaling factor is total assets, and for the income statement it is sales. Therefore, all the income statement line items are divided by sales, while all balance sheet line items are divided by total assets.

The common-size income statement and the common-size balance sheet are shown for Apple Inc. (AAPL). Over the last seven years, Apple has been able to lower its operating expenses as a percentage of sales by over 20 percentage points, thereby boosting its operating income. This has been felt by the company's bottom line, where net income as a percentage of sales has risen over 16 percentage points since 2006.

On the balance sheet side, common-size financials allow you to see if there are trends developing in the area where the company is receiving its capital and utilizing it. In Apple's case, the company's assets have shifted over the years from a majority in current assets to a large portion in long-term investments now. Total current assets, which consist of cash, short-term investments, inventories, etc., as a percentage of total assets, have dropped by over 50 percentage points since 2006. This trend is not surprising. Though Apple has been incorporated for a number of years, it has recently gone through a tremendous growth period. The company needed to expand operations significantly in order to keep up with the rise in demand for its products, leading to an increase in long-term investments.

On the liability side, Apple famously does not take on any debt (though the company has recently announced that it will use debt to return capital to shareholders). As you can see, Apple has kept its short- and long-term debt at 0% and has slowly decreased its current liabilities such as accounts payable. Companies that have a very high percentage of liabilities to total debt and equity find it difficult, or more expensive, to issue additional debt should the need arise.

Comparing Companies With Common-Size Data

Beyond analyzing trends in an individual company, common-size data can also be useful when comparing companies to one another. It eliminates company size from the equation, making it easier to compare companies that are of significantly different sizes.

For this discussion, we compare two companies in the major drug industry (as defined by Reuters): Pfizer Inc. (PFE) and Eli Lilly & Co. (LLY). We show Pfizer income items on a total basis and Pfizer

income items on a common-size basis, as well as Eli Lilly income items on a total basis and Eli Lilly income items on a common-size basis. During its latest fiscal year ended December 31, 2012, Pfizer had $59.0 billion in sales while Eli Lilly had sales of $22.6 billion. Given the disparity in the sales numbers, trying to compare their financial statement figures is difficult. However, by converting the figures to a common size, which *Stock Investor Pro* does for you, the companies are placed on a level playing field. In other words, common size allows you to compare apples to apples. Again, to convert to common size, the income statement line items are presented as percentage of sales.

For example, you may want to compare research and development (R&D) spending for Pfizer and Eli Lilly. R&D plays a vital role in the drug industry—it is through this research that companies find their next blockbuster. Looking at the reported figures for these two companies, Pfizer, in real money terms, spent about 39% more on research and development than Eli Lilly. Based on these numbers, Pfizer certainly appears to be better positioned to develop new drugs that could power its future growth. However, the picture changes when looking at the common-size data. Eli Lilly spends more than 23.4% of its revenues on R&D, while Pfizer only spends 12.4%. Pfizer, however, does currently have a better net margin than Eli Lilly, with 24.7% of revenues turning into net income, while Eli Lilly's net margin is 18.1%.

PRINTING PER SHARE, PERCENT CHANGE AND COMMON SIZE DATA

Using the Comprehensive Reports in the program you can print per share, percent change and common-size data for individual companies or a group of companies such as a portfolio or the results of a screen.

To print reports, click on the printer icon on the toolbar at the top of the program window or click on File and select Print (File - Print). This will open the Available Reports window, where you will see a list of all the reports. Click on Comprehensive Company Report, either Selected Company (to print a report for the company that is currently highlighted in the Stock Notebook) or All Companies in Active Notebook (to print the report for all the companies that are currently in the Stock Notebook). Once you have selected the type of report you wish to print, click on Print to print the report, or Preview to generate a report that is viewable on your computer screen. The Comprehensive Company Report window that appears next allows you to specify the data you wish to include in the report. To select a data group for the report, click in the white box to the left of the data group so that a check mark appears in the box. For this example, we select Percent Change (same-quarter) under Financial - Quarterly along with Per Share, Percent Change (year-to-year) and Common Size under Financial - Annual. One you are done, click Ok and the report will print or it will appear on your screen if you chose to preview it.