2 Analyzing Financial Statements and Ratios

KEY CONCEPTS

- accounts receivable
- acid-test ratio
- assets
- balance sheet
- contingent liabilities
- cost of goods sold
- current liabilities
- current ratio
- debt ratio
- double-entry bookkeeping
- earnings before interest and taxes (EBIT)
- expenses
- generally accepted accounting principles (GAAP)
- income statement
- interest coverage ratio
- inventory turnover ratio
- leverage
- liabilities
- liquidity
- long-term liabilities
- market value
- net profit margin ratio
- owners' equity
- price-to-earnings ratio (P/E ratio)
- quick ratio
- return on equity ratio
- revenues
- statement of cash flows
- total asset turnover ratio

Introduction

The 2003 publication of *Moneyball: The Art of Winning an Unfair Game* popularized the use of objective, evidence-based decision making in the sport industry. Michael Lewis' book details the inner workings of the front office of the Oakland Athletics baseball club and how Athletics General Manager Billy Beane and his staff utilized objective data and statistical analysis to gain a competitive advantage over other Major League Baseball teams, most of which could afford to dramatically outspend the Athletics for talent.

For the sport industry, as in other industries, the use of quantitative data and objective decision making in financial analysis is vital. Just as baseball general managers use analytical tools such as on-base plus slugging percentage (OPS) and value over replacement player (VORP) to objectively scrutinize players' production and value, financial analysts use accounting data, summarized in documents such as balance sheets and income statements, to compute metrics that allow them to examine the financial strength and performance of an organization. The results of this type of financial analysis provide insights to a variety of the organization's stakeholders, including its management, customers, current and potential investors, lenders, and suppliers. Each of these stakeholders may be concerned with the past, present, and likely future financial performance and status of the organization. Just as a baseball executive is disadvantaged by not fully understanding objective statistical analysis (as described in *Moneyball*), so too is a manager in the sport industry who does not grasp the tools of financial analysis. This chapter will provide the foundation for understanding financial analysis. It focuses first on financial statements, such as the balance sheet, that use accounting data to provide a summary of financial performance. The latter portion of the chapter focuses on the computation of financial ratios that provide objective interpretations of the data provided by key financial statements.

FINANCIAL STATEMENTS

Just as the general manager or coach/manager reviews statistical records in order to evaluate the performance of a sports team, the manager of a business organization examines data to evaluate the organization's financial health and performance. The primary source of this type of data is the company's financial statements. Financial statements are the equivalent of box scores or statistics sheets, allowing managers to assess the organization's financial status.

The three basic financial statements are the balance sheet, the income statement, and the statement of cash flows. Each of these is examined in this chapter. These financial statements are constructed from the organization's accounting records. Their preparation typically follows **generally accepted accounting principles (GAAP),** which are a standard set of guidelines and procedures for financial reporting. Individuals who wish to better understand the financial operations of an organization would benefit by obtaining some accounting background. (A detailed examination of accounting principles is beyond the scope of this text.)

Publicly traded companies—those whose stock is traded on one of the many stock exchanges that exist in the United States, such as the New York Stock

Exchange (NYSE) and National Association of Securities Dealers Automated Quotations (NASDAQ), and internationally, such as the London and Tokyo stock exchanges—are required to release their financial statements to the public regularly. Private firms, including the vast majority of North American professional sport organizations, are generally not required to disclose financial statements or other related information to the public.

To illustrate concepts relating to financial statements, as well as other concepts in this chapter, we will examine financial statements from two sport industry organizations throughout the next sections. Exhibits 2.1, 2.3, and 2.5 present financial statements for Under Armour, a Baltimore-based apparel company perhaps best known for its performance sportswear. Under Armour is a publicly held corporation whose stock is traded on the New York Stock Exchange. As such, Under Armour is required to release its financial data to the public on both a quarterly and an annual basis. The financial statements included in this chapter are from Under Armour's 2008 annual report. Exhibits 2.2 and 2.4 display financial statements for the Green Bay Packers of the National Football League. As discussed in the previous chapter, the Packers are unique among NFL teams in being owned publicly by stockholders, whereas all other NFL teams are privately owned by individuals. As privately owned businesses rather than publicly held corporations, the other NFL teams are not required to share their financial data with the public. The Packers, being publicly held, release the team's financial statements during its annual shareholder meeting each summer.

SIDEBAR

Publicly Traded Companies in the Sport Industry 2.A

Stock in dozens of sport industry organizations is available for trade on various stock exchanges, including both well-known exchanges such as the NYSE and NASDAQ and smaller ones such as the American Stock Exchange (AMEX). Examples of publicly traded sport organizations include sports apparel and sporting goods companies such as Nike, Reebok, and Callaway Golf; media companies, including Walt Disney (which owns ESPN) and Comcast; and motorsports companies such as International Speedway Corp. and Speedway Motorsports, each of which owns and operates NASCAR racetracks. Not represented among publicly traded companies are professional sports franchises. Currently, no major North American professional team is a publicly traded corporation, although some teams, such as the New York Knicks and Rangers, owned by Cablevision, are subsidiaries, or parts, of publicly traded corporations. In the 1980s and '90s, franchises such as the Boston Celtics, Florida Panthers, and Cleveland Indians sold stock through major exchanges; however, each of those teams has since privatized its ownership.

The Balance Sheet

The **balance sheet** is a picture or snapshot of the financial condition of an organization at a specific point in time. The balance sheet is unique among the financial statements in that it represents the organization's financial condition *on the date on which it is prepared* (thus the reference to the snapshot or picture), whereas the other two financial statements reflect the organization's financial performance over a period of time. The balance sheet is organized in three primary sections: assets, liabilities, and owners' equity. A company's **assets** are what it owns, including items such as cash, inventory, and **accounts receivable,** or the money a company is owed by customers. **Liabilities,** conversely, are the organization's financial obligations or debts owed to others. **Owners' equity,** which is also referred to as shareholders' equity or stockholders' equity, is an estimated measure of the ownership value of the company. On the balance sheet, owners' equity is equal to the company's assets minus its liabilities. Stated differently, the balance sheet is always

truly "in balance," as the assets—the first half of the statement—must equal the total of the liabilities and owners' equity—the second half of the balance sheet. This balance is assured through the use under GAAP of **double-entry bookkeeping,** where each transaction made by an organization is entered or recorded twice, once on the debit side of the accounting records and once on the credit side. The result of this accounting system is a balanced sheet, where the sum of the organization's assets is equal to the combined sum of its liabilities and owners' equity. Exhibits 2.1 and 2.2 display balance sheets for Under Armour and the Green Bay Packers, respectively. Note on Exhibit 2.1 that Under Armour's assets at the end of 2008 were equal to the total of its liabilities and shareholders' equity, as follows:

assets = liabilities + shareholders' equity

$487.555 million = $156.458 million + $331.097 million

Assets on a balance sheet are listed in order of **liquidity,** or how quickly the asset can be converted into cash, with the most liquid assets listed first. Hence, cash will almost always be the first asset listed, at the top of the balance sheet. Further, assets are typically divided into the categories of *current assets* and *long-term assets*. Current assets are those that are likely to be converted into cash within one year's time. Liabilities are similarly listed according to their maturity, or when the liability or debt is due to be paid by the organization. Liabilities with the earliest maturity dates are listed first. Liabilities due within one year are labeled **current liabilities,** and those due after one year are labeled **long-term liabilities.** Common examples of current liabilities include employee salaries and accounts payable, or purchases from suppliers on credit, whereas long-term liabilities include mortgage loans for facility construction or renovation and employee pension obligations.

As stated previously, owners' equity, or assets minus liabilities, represents an estimate of the value or ownership stake of the company. It should be noted that this figure is often a very rough and inaccurate estimate, for several reasons (Shapiro & Balbirer, 2000). First, asset and liability figures represent the items' value at the time of purchase, not necessarily their present value. Land bought decades ago would be listed as an asset on the balance sheet at the cost that was paid for the land at that time, even if that land has increased in value many times since then. Second, the assets listed on the balance sheet do not include intangible assets such as branding, management expertise, or product positioning. Nike's balance sheet, for example, does not account for the value of its brand and the "swoosh" mark developed through countless marketing campaigns over the past three decades. Third, the balance sheet does not include **contingent liabilities,** debts that may or may not occur, such as the result of ongoing litigation against the company. Contingent liabilities are frequently disclosed in a notes or footnotes section associated with the balance sheet and other financial statements.

An examination of the balance sheets in Exhibits 2.1 and 2.2 reveals considerable differences in terminology. GAAP establishes standard procedures for accounting and the reporting of information on financial statements, but it allows considerable flexibility for companies to report their financial data in a manner that is appropriate for their particular business enterprise. If you find terminology in the balance sheet or other financial statements unfamiliar or confusing, note that many of these terms and concepts will be explained throughout this chapter.

exhibit 2.1

Under Armour, Inc. and subsidiaries consolidated balance sheets (in thousands, except share data).

	DECEMBER 31, 2008	DECEMBER 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$102,042	$40,588
Accounts receivable, net	81,302	93,515
Inventories	182,232	166,082
Prepaid expenses and other current assets	18,023	11,642
Deferred income taxes	12,824	10,418
Total current assets	$396,423	$322,245
Property and equipment, net	73,548	52,332
Intangible assets, net	5,470	6,470
Deferred income taxes	8,687	8,173
Other non-current assets	3,427	1,393
TOTAL ASSETS	$487,555	$390,613
Liabilities and Stockholders' Equity		
Current liabilities		
Revolving credit facility	$25,000	—
Accounts payable	72,435	$55,012
Accrued expenses	25,905	36,111
Current maturities of long-term debt	7,072	4,111
Current maturities of capital lease obligations	361	465
Other current liabilities	2,337	—
Total current liabilities	$133,110	$95,699
Long-term debt, net of current maturities	13,061	9,298
Capital lease obligations, net of current maturities	97	458
Other long-term liabilities	10,190	4,673
TOTAL LIABILITIES	$156,458	$110,128
Stockholders' equity		
Class A Common Stock, $.0003 1/3 par value (100,000,000 shares authorized as of December 31, 2008 and 2007; 36,808,750 shares issued and outstanding as of December 31, 2008, and 36,189,564 shares issued and outstanding as of December 31, 2007)	$ 12	$ 12
Class B Convertible Common Stock, $.0003 1/3 par value (12,500,000 shares authorized, issued and outstanding as of December 31, 2008 and 2007)	4	4
Additional paid-in capital	174,725	162,362
Retained earnings	156,011	117,782
Unearned compensation	(60)	(182)
Accumulated other comprehensive income	405	507
Total stockholders' equity	$331,097	$280,485
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$487,555	$390,613

exhibit 2.2 Green Bay Packers balance sheets.

FISCAL YEAR ENDED MARCH 31,	2009	2008
Assets		
Current assets		
Cash	$3,632,166	$0
Inventories	4,164,838	1,666,631
Unamortized signing bonuses	14,943,628	15,530,776
Accounts receivable	9,710,475	7,191,971
Deferred income taxes	7,425,157	7,449,867
Other current assets	3,974,229	2,055,972
Total current assets	$43,850,493	$33,895,217
Investments	$166,035,479	$216,324,253
Property & equipment, net	50,731,444	48,871,670
Other assets		
Unamortized signing bonuses	15,266,649	27,613,660
Deferred income taxes	0	0
Other non-current assets	22,447,772	10,912,760
Total other assets	$37,714,421	$38,526,420
TOTAL ASSETS	$298,331,837	$337,617,560
Liabilities and Stockholders' Equity		
Current liabilities		
Cash overdraft		
Current maturities of long-term liabilities (deferred compensation)	$4,948,206	$4,240,425
Notes payable	1,001,169	13,768,155
Accounts payable	2,784,481	3,609,180
Accrued expenses	12,317,625	24,114,093
Accrued income taxes	0	0
Deferred revenues	10,099,549	3,137,558
Total current liabilities	$31,151,030	$48,869,411
Long-term liabilities		
Note payable	$8,466,997	$8,100,000
Deferred compensation	11,346,314	13,133,884
Litigation settlement	0	0
Deferred income taxes	0	0
Other	14,243,022	12,947,511
TOTAL LONG-TERM LIABILITIES	$34,056,333	$34,181,395
Stockholders' equity		
Common stock and additional paid-in capital	$22,335,711	$22,335,711
Retained earnings	232,418,674	228,396,734
Unrealized gain on investments, net		
Accumulated other comprehensive income	(21,629,911)	3,834,309
Total stockholders' equity	$233,124,474	$254,566,754
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$298,331,837	$337,617,560

Get the sheet.

The Income Statement

The **income statement,** also referred to as the statement of earnings or the profit and loss statement, shows the organization's income over a specified period of time and is typically issued on an annual or quarterly basis. For the specified time period, the income statement lists the organization's **revenues,** or income generated from business activities, such as the sale of goods or services, and the organization's **expenses,** or funds flowing out of the organization as costs of doing business. Exhibits 2.3 and 2.4 provide examples for Under Armour and the Green Bay Packers. When expenses are subtracted from revenues, the resulting figure is the organization's net income (or net loss, if expenses were greater than revenues over the period of time). Net income is frequently referred to as profits or earnings.

An organization's books may be kept on a cash basis or an accrual basis, and it is important to note the differences between these two methods and the resulting impact on the income statement. *Cash basis accounting* recognizes transactions when money is either received or paid out. *Accrual basis accounting,* on the other

Under Armour, Inc. and subsidiaries consolidated income statements (in thousands, except per share amounts). **exhibit 2.3**

	YEAR ENDED DECEMBER 31,		
	2008	2007	2006
Net revenues	$725,244	$606,561	$430,689
Cost of goods sold	370,296	301,517	215,089
Gross profit	$354,948	$305,044	$215,600
Operating expenses			
Selling, general, and administrative expenses	278,023	218,779	158,682
Income from operations	$76,925	$86,265	$56,918
Interest income (expense), net	(850)	749	1,457
Other income (expense), net	(6,175)	2,029	712
Income before income taxes	$69,900	$89,043	$59,087
Provision for income taxes	31,671	36,485	20,108
Net income	$38,229	$52,558	$38,979
Net income available per common share			
Basic	$0.79	$1.09	$0.83
Diluted	$0.77	$1.05	$0.79
Weighted average common shares outstanding			
Basic	48,569	48,021	46,983
Diluted	49,890	49,959	49,587

exhibit 2.4 Green Bay Packers income statements.

Get the sheet.

FISCAL YEAR ENDED MARCH 31,	2009	2008
Operating Income		
Ticket & media income		
Home games, net	$31,097,266	$30,889,618
Road games	16,175,953	15,138,643
Television and radio	94,484,631	87,584,700
Total ticket and media income	$141,757,850	$133,612,961
Other operating income		
Private box income	$12,827,613	$12,059,952
NFL properties income (other NFL revenue)	36,458,755	32,853,116
Expansion\revenue sharing income		
Marketing\pro shop, net	43,717,750	50,256,737
Atrium revenue (added 2004)		
Other: local media, concessions, and parking (net)	13,167,973	12,552,566
Total other operating income	$106,172,091	$107,722,371
Total operating income	$247,929,941	$241,335,332
Operating Expenses		
Player costs	$138,697,272	$124,651,348
Game expenses (operations/maintenance, net)	7,700,551	7,567,872
General and administrative	31,693,990	35,227,539
Team expenses	26,394,103	26,459,884
Sales and marketing expenses	23,334,394	26,008,492
Pro shop expenses		
Atrium expenses		
Lambeau redevelopment costs		
Total operating expenses	$227,820,310	$219,915,135
Profit (loss) from operations	$20,109,631	$21,420,197
Other income (Expense)		
Interest expense		
Interest and dividend income		
Gain on sale of investments and other assets, net		
Other income (expense)	$(11,187,691)	$14,369,619
Income before expansion revenue and provision for income taxes	8,921,940	35,789,816
Provision for income taxes	4,900,000	12,425,000
Net income before expansion revenue	$4,021,940	$23,364,816

hand, accounts for income when it is earned and expenses when they are incurred, rather than when the money is exchanged. For example, if Under Armour makes a major sale in fiscal year (FY) 1 but does not actually receive payment until FY 2, under accrual basis accounting, the sale is included as revenue on Under Armour's FY 1 income statement. (A **fiscal year** is a 12-month period over which a company budgets its money; it may or may not begin in January, and so the term *fiscal year* distinguishes it from the calendar year.) Under cash basis accounting, the money would be included as revenue only when it is received in FY 2. Some sole proprietorships and other businesses utilize cash basis accounting, but most corporations and partnerships are required by GAAP to follow accrual basis accounting. The limitation of cash basis accounting, as it pertains to the income statement, is that sales made during a particular time period cannot be recognized on the income statement if payment has not yet been received, even if payment is forthcoming. Under accrual basis accounting, the lag time between when a transaction is made and when payment is exchanged is acknowledged through another financial statement, the statement of cash flows, to be discussed later in this chapter.

SIDEBAR

The Birth and Growth of Under Armour 2.B

The corporate history of Under Armour (UA) is not a long one, as UA started in 1996, but it is one of tremendous growth. UA founder and CEO Kevin Plank was a football player at the University of Maryland in the 1990s. Like many athletes, Plank tired of sweating through cotton t-shirts each practice and workout, and wearing those heavy, wet shirts as a result. In 1995, as a senior, he found a fabric similar to the skin-tight compression shorts players wore and had some shirts made from that fabric. Plank refined the shirts through trial and error, testing his product on fellow University of Maryland athletes. Plank graduated in 1996 and launched UA. The company sold 500 shirts that first year, resulting in $17,000 in sales. UA has grown quickly since, with sales of $25 million in 2001, $430 million in 2006, and $725 million in 2008. While it may be unlikely that UA will continue to grow at this same rapid rate, the company is posed to be a formidable competitor in the sports apparel industry for the foreseeable future.

Experts disagree about whether income statements truly reflect actual earnings or profit (Higgins, 2009; Shapiro & Balbirer, 2000). For example, when firms account for depreciation (the reduction in value of an asset due to age or use), a number of options are available, and the approach chosen can greatly influence expenses, and thus net income or loss, on the income statement. A related issue is taxation. Accounting decisions—particularly in regard to depreciation and inventory—are frequently made in an effort to minimize taxes. This can result in financial statements, especially income statements, that lack objectivity. Another issue is how the company accounts for expenditures in the areas of research and development (R&D) and advertising. These two areas represent investments in the future revenues of the company, yet they are typically accounted as expenditures when spent rather than in the future, when their benefits are reaped. If a company makes cuts in these areas in difficult times, the result may be an increased net income (or decreased net loss) in the short term. Such action could, however, be harmful to the long-term future of the company.

The Statement of Cash Flows

For any company to be successful in the long term, it must generate more cash than it spends, known as a positive cash flow. Negative cash flows may be sustainable in the short term, but few companies can survive long periods of spending more than they generate. The income statement and balance sheet, however, do not provide insight into this simple fact.

Whereas the income statement provides information about the revenues and expenses flowing into and out from an organization, the **statement of cash flows** tracks cash in and cash out. The ability to track cash coming into and going out of the business is of particular importance to an organization that uses accrual basis accounting. The cash flows statement provides data as to whether the company has sufficient cash on hand to meet its debts and obligations, which is not provided by the balance sheet or the income statement of firms utilizing accrual basis accounting. In addition to revealing differences between accrual basis accounting and cash transactions, the statement of cash flows is free from the influence of noncash expenses, such as depreciation—unlike the income statement. On the income statement, the depreciation of an asset such as a stadium or an office building is listed as an expense, yet depreciation does not reflect any true monetary expenditure. The statement of cash flows provides a simpler examination of cash generated and spent. Exhibit 2.5 is Under Armour's statement of cash flows from its 2008 annual report.

Whereas the balance sheet states the status of the company's assets, liabilities, and equity at a single point in time, without showing trends over time, the statement of cash flows examines cash transactions over a period of time and so can provide additional context for the information in a balance sheet.

exhibit 2.5 Under Armour, Inc. and subsidiaries consolidated cash flow statements (in thousands).

YEAR ENDED DECEMBER 31,	2008	2007	2006
Cash flows from operating activities			
Net income	$38,229	$52,558	$38,979
Adjustments to reconcile net income to net cash provided by (used in) operating activities			
Depreciation and amortization	21,347	14,622	9,824
Unrealized foreign currency exchange rate (gains) losses	5,459	(2,567)	161
Loss on disposal of property and equipment	15	—	115
Stock-based compensation	8,466	4,182	1,982
Deferred income taxes	(2,818)	(4,909)	(6,721)
Changes in reserves for doubtful accounts, returns, discounts, and inventories	8,711	4,551	3,832
Changes in operating assets and liabilities:			
Accounts receivable	2,634	(24,222)	(20,828)
Inventories	(19,497)	(83,966)	(26,504)
Prepaid expenses and other assets	(7,187)	(2,067)	(3,997)
Accounts payable	16,957	11,873	8,203
Accrued expenses and other liabilities	(5,316)	11,825	10,681
Income taxes payable and receivable	2,516	3,492	(5,026)
Net cash provided by (used in) operating activities	$69,516	$(14,628)	$10,701

Continued. exhibit 2.5

	2008	2007	2006
Cash flows from investing activities			
Purchase of property and equipment	$(38,594)	$(33,959)	$(15,115)
Purchase of intangible assets	(600)	(125)	—
Purchase of trust-owned life insurance policies	(2,893)	—	—
Proceeds from sales of property and equipment	21	—	—
Purchases of short-term investments	—	(62,860)	(89,650)
Proceeds from sales of short-term investments	—	62,860	89,650
Net cash used in investing activities	$(42,066)	$(34,084)	$(15,115)
Cash flows from financing activities			
Proceeds from revolving credit facility	$40,000	$14,000	—
Payments on revolving credit facility	(15,000)	(14,000)	—
Proceeds from long-term debt	13,214	11,841	$ 2,119
Payments on long-term debt	(6,490)	(2,973)	(2,413)
Payments on capital lease obligations	(464)	(794)	(1,840)
Excess tax benefits from stock-based compensation arrangements	2,131	6,892	11,260
Proceeds from exercise of stock options and other stock issuances	1,990	3,182	3,544
Payments of debt financing costs	—	—	(260)
Payments received on notes from stockholders	—	—	169
Net cash provided by financing activities	35,381	18,148	12,579
Effect of exchange rate changes on cash and cash equivalents	(1,377)	497	(487)
Net increase (decrease) in cash and cash equivalents	$61,454	$(30,067)	$ 7,678
Cash and cash equivalents			
Beginning of year	$40,588	$70,655	$62,977
End of year	102,042	40,588	70,655
Non-cash financing and investing activities			
Fair market value of shares withheld in consideration of employee tax obligations relative to stock-based compensation	—	—	$734
Purchase of property and equipment through certain obligations	$2,486	$1,110	2,700
Issuance of warrants in partial consideration for intangible asset	—	—	8,500
Settlement of outstanding accounts receivable with property and equipment	—	—	350
Reversal of unearned compensation and additional paid-in capital due to adoption of SFAS 123R	—	—	715
Other supplemental information			
Cash paid for income taxes	$29,561	$30,502	$20,522
Cash paid for interest	1,444	525	531

Cash flow statements are typically organized in three sections: operations, investing, and financing. *Operations* refers to the organization's cash flows from normal business operations, such as cash flowing in from the sale of products or services, or cash flowing out to pay employees' salaries. *Investing* activities include the buying and selling of fixed assets, such as the purchase of property. *Financing* refers to the company's debt and equity financing, such as the sale of stock or repayment of a loan. For an example, see Under Armour's statement of cash flows in Exhibit 2.5.

FINANCIAL RATIOS

Just as the general manager of a baseball team can take a sheet of statistics and compute various figures, such as batting average, slugging percentage, and earned run average, in order to evaluate teams and players, a business manager can utilize accounting data provided in the financial statements discussed above in order make similar types of analyses. For example, instead of dividing at bats by hits to find batting average, the business manager may divide net income by shareholders'/owners' equity to calculate a metric called return on equity. The remainder of this chapter focuses on the computation and analysis of similar measures, known as financial ratios. Financial ratios provide key information about the condition and performance of a company and are, therefore, vital for managers to understand. This chapter will focus on many of the most important and commonly used ratios. These ratios are organized into five sections based on their type: liquidity, asset management, financial leverage, profitability, and market value. Exhibit 2.6 summarizes these ratios.

Liquidity Ratios

Recall that liquidity refers to the ability to convert an asset into cash quickly. Liquidity ratios measure an organization's ability to pay its short-term liabilities or debts with its short-term assets. A company that lacks sufficient short-term assets, such as cash, inventory, and accounts receivable, to pay off debts that are coming due in the near future may be forced to refinance its debts or borrow additional money in order to meet its financial obligations.

Current ratio

The most commonly used liquidity measure is the current ratio. The **current ratio** measures the organization's ability to meet its current liabilities (those due within a year) with its current assets. The following formula is used to calculate the current ratio:

$$\text{current ratio} = \frac{\text{current assets}}{\text{current liabilities}}$$

Both current assets and current liabilities are found on the balance sheet. Using data from Exhibit 2.1, Under Armour's current ratio for December 31, 2008, is calculated as follows:

$$\text{current ratio} = \frac{\$396{,}423{,}000}{\$133{,}110{,}000} = 2.98$$

Summary of key financial ratios. exhibit 2.6

RATIO	DESCRIPTION	FORMULA
Liquidity Ratios		
current ratio	The organization's ability to meet its current liabilities (those due within a year) with its current assets	$\frac{\text{current assets}}{\text{current liabilities}}$
quick ratio	The organization's ability to meet its current liabilities with current assets other than inventory	$\frac{\text{current assets} - \text{inventory}}{\text{current liabilities}}$
Asset Management Ratios		
total asset turnover ratio	How efficiently the organization is utilizing its assets to make money	$\frac{\text{net sales}}{\text{average total assets}}$
inventory turnover ratio	How often the organization sells and replaces its inventory over a specified period of time	$\frac{\text{cost of goods sold}}{\text{average inventory}}$
Leverage Ratios		
debt ratio	How the organization finances its operation with debt and equity	$\frac{\text{total liabilities}}{\text{total assets}}$
interest coverage ratio	The organization's ability to pay the interest on its debt owed	$\frac{\text{earnings before interest and taxes (EBIT)}}{\text{interest expense}}$
Profitability Ratios		
net profit margin	The percentage of the organization's total sales or revenues that was net profit or income	$\frac{\text{net income}}{\text{sales or revenues}}$
return on equity	The return rate that the organization's owners or shareholders are receiving on their investment	$\frac{\text{net income}}{\text{shareholders' or owners' equity}}$
Market Value Ratios		
market value	An estimate of the organization's worth according to the stock market	price per share of common stock x number of outstanding shares
price-to-earnings ratio	An estimate of how much money investors will pay for each dollar of the organization's earnings	$\frac{\text{price per share of common stock}}{\text{earnings per share}}$

(We add three zeroes to each of the values from the balance sheet because the figures in Exhibit 2.1, except for stock share information, are abbreviated and rounded to the nearest thousand.) The current ratio suggests that Under Armour has the ability to cover its short-term liabilities nearly three times over with current assets. Likewise, the Green Bay Packers' current ratio for March 31, 2009, can be calculated from data from their balance sheet (see Exhibit 2.2):

$$\text{current ratio} = \frac{\$43{,}850{,}493}{\$31{,}151{,}030} = 1.41$$

In general, a higher current ratio figure is preferable, as it represents a healthy ability to cover debts with assets such as cash and accounts receivable. A company with a high current ratio is less likely to need to convert longer-term assets into cash or borrow money to cover liabilities. It is possible, however, for a current ratio to be too high. This may represent inefficient company management that is not maximizing the use of its cash balance or that is carrying excessive inventory (Helfert, 2002; Shapiro & Balbirer). A current ratio near 2:1 is commonly viewed as a good target for many companies (Helfert). Using this standard, Under Armour's current ratio of 2.98 may be seen as overly high.

It should be noted, however, that current ratio values—as well as most other financial ratios—must be evaluated in context, especially when we are using them as comparative tools. The first context in which financial ratios should be viewed is against other firms within the same industry. Before making a judgment as to whether Under Armour's current ratio is excessive, we should compare it to that of rival companies, such as Nike. Another important context for comparison is the company's own history. Financial ratios should be examined relative to their values in previous time periods to evaluate trends in the company's financial position.

Quick/Acid-test ratio

Another frequently used measure of liquidity is the **quick ratio,** also known as the **acid-test ratio.** Like the current ratio, the quick ratio provides information about the organization's ability to meet its current liabilities with current assets. The quick ratio, however, does not include inventory among current assets. If a company faces a financial emergency and needs to convert assets into cash in order to meet pending obligations, inventory is likely to be difficult to convert into cash as quickly as other assets. It may take months for a company to sell its inventory at full value, or the company may have to discount the inventory deeply to sell it rapidly. According to Higgins (2009), sellers may receive 40% or less of inventory's book value through a liquidation sale. Because inventory is viewed as being the least liquid of a company's current assets, the quick ratio is often useful as a more conservative alternative to the current ratio.

The quick ratio is simply a modified version of the current ratio. It is calculated as follows:

$$\text{quick ratio} = \frac{\text{current assets} - \text{inventory}}{\text{current liabilities}}$$

The inventory value may be found on the balance sheet. Under Armour's quick ratio for December 31, 2008, is calculated as follows:

$$\text{quick ratio} = \frac{\$396{,}423{,}000 - \$182{,}232{,}000}{\$133{,}110{,}000} = 1.61$$

Under Armour can cover its short-term liabilities 1.61 times over with its current assets other than inventory. For an apparel company with significant inventory, this signifies that Under Armour is not overly encumbered with short-term debt and has sufficient assets to cover that debt if necessary. The Green Bay Packers' quick ratio for March 31, 2009, can also be calculated from data from the balance sheet:

$$\text{quick ratio} = \frac{\$43{,}850{,}493 - \$4{,}164{,}838}{\$31{,}151{,}030} = 1.27$$

As a professional sport franchise, the Packers do not possess significant inventory. Hence, it should not be surprising that the current ratio and quick ratio have similar values. The Packers' inventory may consist of apparel and merchandise in team souvenir shops, for example, but it is relatively small when compared to the inventory of a sports apparel corporation such as Under Armour. Recall that financial ratios should be compared against those of industry competitors. In the case of the Packers, we would examine other professional sport franchises.

Asset Management Ratios

How effectively a company utilizes its assets and resources to generate sales is important information for business managers. All companies have a limited amount of resources. Those that are most efficient in using those limited resources to produce sales are likely to be successful. Several ratios measure companies' asset management. Two of the most common are the total asset turnover ratio and the inventory turnover ratio.

Total asset turnover ratio

One measure of how efficiently an organization is utilizing its assets to make money is the **total asset turnover ratio.** This ratio requires information from both the company's balance sheet and its income statement, in the following formula:

$$\text{total asset turnover ratio} = \frac{\text{net sales}}{\text{average total assets}}$$

The net sales value, sometimes labeled as net revenues, is found on the income statement (see the Under Armour example in Exhibit 2.3). Total assets, which includes both current assets and long-term assets, is listed on the balance sheet. To find average total assets, we average the company's total assets at the beginning and at the end of the period of interest, often the fiscal year. For Under Armour, these asset values are given in Exhibit 2.1. Total assets at the end of 2008 were $487,555,000. The beginning-of-period total assets are assumed to be identical to total assets at the end of the previous period—in this case, December 31, 2007—which were $390,613,000. We average these two figures to find the average total assets value. The entire calculation proceeds as follows:

$$\text{total asset turnover ratio} = \frac{\$725{,}244{,}000}{(\$487{,}555{,}000 + \$390{,}613{,}000) / 2}$$

$$= \frac{\$725{,}244{,}000}{\$439{,}084{,}000}$$

$$= 1.65$$

In FY 2008 Under Armour's revenues exceeded assets by a considerable amount, suggesting that the company is using its assets efficiently.

Data from Exhibits 2.2 and 2.4 allow us to calculate the Green Bay Packers' total asset turnover ratio for FY 2009. On the Packers' income statement, net sales is represented by total operating income. The calculation is as follows:

$$\text{total asset turnover ratio} = \frac{\$247,929,941}{(\$298,331,837 + \$337,617,560) / 2}$$

$$= \frac{\$247,929,941}{\$317,974,699}$$

$$= 0.78$$

The Green Bay Packers' revenues were 78% of their assets at the end of the 2009 fiscal year. As with other ratios, these values should be compared to the organization's own historical values as well as to industry competitors for analysis.

Inventory turnover ratio

Another ratio that is useful in evaluating asset management is the **inventory turnover ratio,** which measures how often a company sells and replaces its inventory over a specified period of time, typically a year. For some firms, particularly those in manufacturing and retail, this is an especially important ratio, as inventory is often a large asset for these companies. A manufacturer—like Under Armour—that must sell a high volume of relatively low priced products in order to be profitable must turn over its existing inventory frequently. If the inventory is sitting in warehouses and on shelves rather than being sold in a timely manner, it will be difficult for the company to be financially successful.

Inventory turnover ratio is calculated with the following formula:

$$\text{inventory turnover ratio} = \frac{\text{cost of goods sold}}{\text{average inventory}}$$

Cost of goods sold (COGS) includes those costs that are directly attributable to the production of goods or products to be sold, including raw materials and labor costs. Cost of goods sold, sometimes labeled *cost of sales,* is typically listed immediately after net sales (or net revenues), near the top of the income statement. Recall that inventory is found on the balance sheet, and we calculate average inventory by finding the average of the inventory values at the beginning and the end of the time period of interest.

Using data from Exhibits 2.1 and 2.3, we calculate Under Armour's inventory turnover ratio for 2008 as follows:

$$\text{inventory turnover ratio} = \frac{\$370,296,000}{(\$182,232,000 + \$166,082,000) / 2}$$

$$= \frac{\$370,296,000}{\$174,157,000}$$

$$= 2.13$$

To interpret this figure, we may say that Under Armour turned over, or sold and replenished, its inventory 2.13 times during 2008. Of course, in general, a higher value is preferred. Once again, note that this value is difficult to interpret without comparisons to industry competitors and the company's own history. This particular ratio is especially industry-specific. Industries that sell very low cost items, such as a grocery store, are likely to turn over inventory much more rapidly

than industries selling luxury items, such as jewelry or yachts. Inventory turnover ratio values should reflect these differences. While the inventory turnover ratio is a vital metric for manufacturers (like Under Armour) and retail companies, it is not an important indicator for a sport franchise such as the Green Bay Packers. Because the Packers do not produce goods in the same way that Under Armour does, the Packers do not report a cost of goods sold or cost of sales value on their income statement (see Exhibit 2.4). Accordingly, the inventory turnover ratio for the Packers is not presented here.

Leverage Ratios

Leverage refers to how a company chooses to finance its operation with debt versus equity. A company that relies extensively on borrowing money to operate is considered to be heavily leveraged. Such a company faces greater risk of financial problems than one not so reliant on debt.

Debt ratio

A useful financial leverage ratio is the **debt ratio,** sometimes referred to as the debt-to-assets ratio. The debt ratio is a quite simple, yet telling measure of an organization's leverage. It is calculated with the formula:

$$\text{debt ratio} = \frac{\text{total liabilities}}{\text{total assets}}$$

Both total liabilities and total assets are found on the balance sheet. (Total assets is equal to current plus short-term assets, and total liabilities is equal to current plus long-term liabilities.) A lower debt ratio is generally preferable, as a higher value signifies heavier borrowing and increased financial risk. This ratio is unique among those presented in this chapter; with all other ratios, a higher value is preferred to a lower one. From data in Exhibit 2.1, we calculate Under Armour's debt ratio for December 31, 2008, as follows:

$$\text{debt ratio} = \frac{\$156{,}458{,}000}{\$487{,}555{,}000} = 0.32$$

Under Armour's debt was approximately one-third of the value of its assets. Note that the debt ratio is often reported in percentage form, in this case 32%. Money borrowed from creditors makes up 32% of the value of Under Armour's assets.

The Green Bay Packers' debt ratio for March 31, 2009, may also be calculated from data in their balance sheet (see Exhibit 2.2):

$$\text{debt ratio} = \frac{\$31{,}151{,}030 + \$34{,}056{,}333}{\$298{,}331{,}837} = 0.22$$

Because the Packers' balance sheet does not list a total liabilities figure, we must add their total current liabilities and total long-term liabilities to find this value ($31,151,030 + $34,056,333). Recall that companies structure their financial statements with slight differences and nuances to fit their own particular operations.

Interest coverage ratio

Another tool for understanding a company's financial leverage is the **interest coverage ratio,** sometimes called the times interest earned ratio. As the name of this ratio implies, the interest coverage ratio measures a firm's ability to pay the interest on its debt. Consider this on an individual level: persons who carry a debt balance on a credit card—as millions do—know that while they may not be able to pay the full balance by the next payment due date, they must at least pay a minimum amount, which is often approximately equivalent to the interest on the balance. This concept applies at the organizational level as well. Many companies may not be able to pay the full amount of debt owed in the short term, but a company that cannot at least pay the interest on its debt is at risk for significant financial problems. The interest coverage ratio measures a company's ability to pay interest on debt out of income or earnings. It is calculated with the following formula:

$$\text{interest coverage ratio} = \frac{\text{earnings before interest and taxes (EBIT)}}{\text{interest expense}}$$

The interest coverage ratio formula involves a term that is common in financial analysis and accounting: **earnings before interest and taxes (EBIT).** EBIT, found on the income statement, is defined as

$$\text{EBIT} = \text{operating revenue} - \text{operating expenses} + \text{non-operating income}$$

The interest expense value is found on the income statement. When a company reports no non-operating income, EBIT is often used synonymously with the terms *operating income* or *operating profit*. Using data from Under Armour's income statement (Exhibit 2.3), we calculate the company's interest coverage ratio for FY 2008 as follows:

$$\text{interest coverage ratio} = \frac{\$76{,}925{,}000}{\$850{,}000} = 90.50$$

Note that Under Armour's income statement labels EBIT as income from operations. The interest coverage ratio value of 90.50 suggests that Under Armour can cover its interest expense more than 90 times over with its earnings or operating income.

The Green Bay Packers' income statement shows that the Packers had no interest expense in the 2009 fiscal year. In this case, the interest coverage ratio for the Packers cannot be calculated and is immaterial.

Profitability Ratios

A primary purpose of a for-profit business is, of course, to generate a profit. A number of financial ratios measure the profitability of a company. We will discuss two of the most useful profitability ratios: net profit margin and return on equity. These ratios evaluate the performance of the company and its management in controlling expenses and generating profit.

Net profit margin ratio

A widely used profitability ratio is net profit margin. The **net profit margin ratio,** the percentage of total sales or revenues that was net profit or income, measures

the effectiveness and efficiency of the organization's operations. A higher value represents a company that is efficient in its production and operations. A low net profit margin may reflect inefficient operations and poor management, as well as a company that would be at risk financially if sales were to decline. Net profit margin is calculated as follows:

$$\text{net profit margin} = \frac{\text{net income}}{\text{sales or revenues}}$$

Both net income and sales or revenues may be found on the income statement. Recall that net income is essentially the "bottom line" of the income statement itself and is traditionally listed near or at the end of the income statement. Conversely, the sales or revenues value is commonly listed at the beginning of the income statement. From data in Exhibit 2.3, we calculate Under Armour's net profit margin for FY 2008 as follows:

$$\text{net profit margin} = \frac{\$38{,}229{,}000}{\$725{,}244{,}000} = 5.27\%$$

Net profit margin is reported in percentage form, as it represents the percentage of sales that returned to the company's ownership in the form of profits on their capital. Under Armour's net profit margin for FY 2008 was a little over 5%. In other words, Under Armour spent nearly 95% of the money generated by sales in 2008 on everything from manufacturing to employee pay to advertising, while approximately 5% was returned to ownership as profit. Again, we must compare this value to the company's own history and to industry competitors in order to draw valid conclusions.

The Green Bay Packers' net profit margin in FY 2009 may be calculated from data from the income statement in Exhibit 2.4, as follows:

$$\text{net profit margin} = \frac{\$4{,}021{,}940}{\$247{,}929{,}941} = 1.62\%$$

The Packers realized just a 1.62% return on their sales as profit in their 2009 fiscal year. In other words, for every dollar in revenue generated, the Packers returned to ownership less than two cents (1.62 cents, to be precise) in profit. Note, however, that as a community-owned professional sports team, the Packers likely do not have the same incentive or motivation to generate large profits as does a more traditional for-profit corporation, such as Under Armour.

Return on equity ratio

Another important measure of profitability is the **return on equity ratio,** which measures the rate of return a company's owners or shareholders are receiving on their investment. Like net profit margin, return on equity bases a measure of efficiency on net income. The return on equity ratio, however, compares net income to shareholders' or owners' equity instead of revenues. The formula is:

$$\text{return on equity} = \frac{\text{net income}}{\text{shareholders' or owners' equity}}$$

Net income is typically found near the end of the income statement. Shareholders' or owners' equity is found on the balance sheet. Under Armour's return on equity for FY 2008 is calculated as follows, from data in Exhibits 2.1 and 2.3:

$$\text{return on equity} = \frac{\$38{,}229{,}000}{\$331{,}097{,}000} = 11.55\%$$

Like net profit margin, return on equity is reported in percentage form, as it represents the percentage of ownership stake or equity that the company's ownership realized as profit during a period of time. Under Armour's return on equity for 2008 was more than 11%. From data in Exhibits 2.2 and 2.4, we calculate the Green Bay Packers' return on equity for FY 2009 as follows:

$$\text{return on equity} = \frac{\$4{,}021{,}940}{\$233{,}124{,}474} = 1.73\%$$

The Packers earned less than a 2% return on their ownership or equity as profit in the 2009 fiscal year. While this may seem low, note that the Packers are a community-owned, non-profit organization. This is unique among major professional sport franchises.

Market Value Ratios

The final set of financial ratios is helpful in estimating the book value of a company. The two ratios discussed in this section, market value and price-to-earnings ratio, are quick methods to estimate the value of a company. Valuation is discussed further in Chapter 10.

Market value ratio

Perhaps the quickest method of estimating the value of a company is by finding its **market value** according to the stock market. A company's market value may be computed with the following formula:

$$\text{market value} = \begin{matrix}\text{price per}\\ \text{share of}\\ \text{common stock}\end{matrix} \times \begin{matrix}\text{number of}\\ \text{outstanding}\\ \text{shares}\end{matrix}$$

While this method for estimating a company's worth is convenient and easy, it is not necessarily the most precise method. One notable problem is that stock prices often reflect investors' speculation about the future potential of a company rather than its present performance (see Chapter 7).

To estimate the value of Under Armour, we can refer to stock information found on the company's balance sheet (Exhibit 2.1) in the stockholders' equity section. Under Armour had 36,808,750 shares of stock outstanding at the end of 2008. (Be careful not to add zeroes to the figures for share information. All values on Under Armour's balance sheet are given "in thousands, except per share amounts"—referring to stock share information.)

Stock price is not available on any of Under Armour's financial statements. Fortunately, numerous sites on the Internet, including Under Armour's own website, provide historical stock price data. Under Armour's stock closed at $23.84

at the end of trading on December 31, 2008, on the New York Stock Exchange. Therefore, the market value of Under Armour on that date was:

$$\text{market value} = 36{,}808{,}750 \text{ shares} \times \$23.84 = \$877{,}520{,}600$$

According to the stock market, Under Armour was worth more than $877 million as of the end of 2008.

Because the Green Bay Packers' stock is not traded publicly on a stock exchange, a stock price is not available, and it is not possible to calculate the Packers' market value using this method.

Price-to-earnings ratio

The **price-to-earnings ratio,** or **P/E ratio,** is a widely used measure of corporate performance and value, particularly among stock market investors. The P/E ratio estimates how much investors will pay for each dollar of a company's earnings (Harrington, 2003). One of the strengths of the P/E ratio is that its scaled nature allows comparisons of the market values of companies of all sizes. The P/E ratio is calculated with the following formula:

$$\text{price-to-earnings ratio} = \frac{\text{price per share of common stock}}{\text{earnings per share}}$$

To calculate the P/E ratio, we must first determine earnings per share, by using the following formula:

$$\text{earnings per share} = \frac{\text{net income}}{\text{number of outstanding shares of common stock}}$$

Recall that net income is found on the income statement, and stock share information is found on the balance sheet. Once we have found earnings per share, we divide the stock price by earnings per share to find the P/E ratio. Using data from Exhibits 2.1 and 2.3, along with the December 31, 2008, stock price, we determine Under Armour's P/E ratio as follows:

$$\text{price-to-earnings ratio} = \frac{\$23.84}{\$38{,}229{,}000 / 36{,}808{,}750}$$

$$= \frac{\$23.84}{\$\ 1.04}$$

$$= 22.95$$

Under Armour's stock price at the end of 2008 was nearly 23 times the company's earnings.

When calculating the P/E ratio, be careful in your use of the data. In this example, we multiplied the net income figure by 1,000, because the income statement gives net income in thousands. The stock share data, however, should not be multiplied by 1,000. Doing so would result in a wildly inaccurate P/E ratio value.

In general, a higher P/E ratio is preferred, but not always. A high P/E ratio can signify subpar earnings or net income, which, of course, is not desirable. Because stock price is a component of the P/E ratio formula, P/E ratio values are heavily influenced by investors' speculation about a company's potential for growth and

success in the future, reflected in the stock price. Companies with high P/E ratio values are often perceived to have high growth potential. In this regard, a P/E ratio says as much about investors' beliefs about the future of a company as it does about present performance (Higgins, 2009).

CONCLUSION

The ability to examine, understand, and calculate financial statements and financial ratios is vital for a financial manager in the sport industry—or any industry, for that matter. Financial statements are comparable to box scores or statistical data that the manager/coach or general manager must be able to read and comprehend in order to understand the performance of players and the team. Financial ratios are analytical tools that help managers evaluate statistical data, just as a calculation tool such as earned run average or slugging percentage helps a baseball executive, or a quarterback's passer rating would help a football executive. This chapter discussed several categories of financial ratios and provided two important examples for each category. Remember that these represent just a few important and commonly used financial ratios, and many more are available to help you analyze companies' performance. Bear in mind that financial ratios should not be examined in isolation, but rather must be compared to the company's own historical data and to competitors' ratios. These provide the context necessary for understanding a company's performance and condition.

CONCEPT check

1. What are the three major sections of the balance sheet? Provide at least one example of items that would be found in each of those sections.
2. What is the primary difference between an income statement and a statement of cash flows?
3. What is the purpose of computing financial ratios?
4. If an organization's current ratio value is below 1.00, what might that suggest about the organization?
5. What information do leverage ratios provide?
6. Why is the price-to-earnings ratio so widely used among investors?
7. This chapter repeatedly states that financial ratios are most valuable when viewed in comparison to the organization's historical ratio values and competitors' values. Why is this context valuable when examining financial ratio values?

PRACTICE problem

If your instructor assigns you the additional practice problem for Chapter 2, here is the link for the major league baseball financials for the problem.

Exhibits 2.7 and 2.8 show a Nike balance sheet and income statement. For the purposes of this problem and the case analysis that follows, use the data for 2009 to compute the ten financial ratios discussed in this chapter for Nike. For the financial ratios using stock data, use Nike's Class B common stock and a price per share of $57.05.

Nike, Inc. consolidated balance sheets. exhibit 2.7

MAY 31,	2009 (IN MILLIONS)	2008 (IN MILLIONS)
ASSETS		
Current assets		
Cash and equivalents	$ 2,291.1	$ 2,133.9
Short-term investments	1,164.0	642.2
Accounts receivable, net	2,883.9	2,795.3
Inventories	2,357.0	2,438.4
Deferred income taxes	272.4	227.2
Prepaid expenses and other current assets	765.6	602.3
Total current assets	$ 9,734.0	$ 8,839.3
Property, plant, and equipment, net	$ 1,957.7	$ 1,891.1
Identifiable intangible assets, net	467.4	743.1
Goodwill	193.5	448.8
Deferred income taxes and other assets	897.0	520.4
Total assets	$13,249.6	$12,442.7
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt	$32.0	$6.3
Notes payable	342.9	177.7
Accounts payable	1,031.9	1,287.6
Accrued liabilities	1,783.9	1,761.9
Income taxes payable	86.3	88.0
Total current liabilities	$ 3,277.0	$ 3,321.5
Long-term debt	$ 437.2	$ 441.1
Deferred income taxes and other liabilities	842.0	854.5
Commitments and contingencies	—	—
Redeemable Preferred Stock	0.3	0.3
Shareholders' equity		
Common stock at stated value		
Class A convertible—95.3 and 96.8 shares outstanding	0.1	0.1
Class B—390.2 and 394.3 shares outstanding	2.7	2.7
Capital in excess of stated value	2,871.4	2,497.8
Accumulated other comprehensive income	367.5	251.4
Retained earnings	5,451.4	5,073.3
Total shareholders' equity	$ 8,693.1	$ 7,825.3
Total liabilities and shareholders' equity	$13,249.6	$12,442.7

Get the sheet.

exhibit 2.8 Nike, Inc. consolidated income statements.

(IN MILLIONS, EXCEPT PER SHARE DATA)

YEAR ENDED MAY 31,	2009	2008	2007
Revenues	$19,176.1	$18,627.0	$16,325.9
Cost of sales	10,571.7	10,239.6	9,165.4
Gross margin	$ 8,604.4	8,387.4	7,160.5
Selling and administrative expense	6,149.6	5,953.7	5,028.7
Restructuring charges	195.0	—	—
Goodwill impairment	199.3	—	—
Intangible and other asset impairment	202.0	—	—
Interest income, net	(9.5)	(77.1)	(67.2)
Other (income) expense, net	(88.5)	7.9	(0.9)
Income before income taxes	$ 1,956.5	$ 2,502.9	$ 2,199.9
Income taxes	469.8	619.5	708.4
Net income	$ 1,486.7	$ 1,883.4	$ 1,491.5
Basic earnings per common share	3.1	3.8	3.0
Diluted earnings per common share	3.0	3.7	2.9
Dividends declared per common share	1.0	0.9	0.7

Get the sheet.

CASE analysis

A Financial Analysis Comparison of Nike and Under Armour

According to the Sporting Goods Manufacturers Association (2009), sporting goods in the United States was a $66 billion industry in 2008. Within the industry, sports apparel was the largest subcategory, generating $29 billion in 2008. Under Armour is an emerging competitor in the sports apparel category, in which Nike has long been recognized as the leader. Using the financial ratios for Nike that you computed in the Practice Problem and the financial ratios for Under Armour provided throughout this chapter, compare the financial health of Nike and Under Armour by answering the questions below.

CASE QUESTIONS

1. In what ratio areas is Nike stronger than Under Armour?
2. In what ratio areas is Under Armour stronger than Nike?
3. If you were an investor considering purchasing stock in either Nike or Under Armour, which company would you choose? Explain and support your answer.

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