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# Introduction to Financial Ratios and Financial Statement Analysis

There is almost always a reason why someone picks up an organization's financial statements and begins to analyze them. Lenders or creditors may be interested in determining whether they will be repaid money they have lent or may lend to the organization. Investors may be interested in comparing a potential investment in one organization with that of another. Employees may want to compare the current performance or financial status of their employer with earlier periods. Regulatory agencies often need to assess organizational or industry financial health and performance. Financial analysis is always based on a set of questions, and the specific questions requiring answers depend on who the financial statement user is and the reasons for his or her analysis.

Financial analyses based on accounting information consistently involve comparisons. Amounts or ratios may be compared with industry norms, the same measurement in a prior period, the same measurement in a competitor's organization, or with planned and budgeted amounts previously established. Figuring out which comparisons will best answer the questions motivating the analysis is one of the necessary steps in making the best use of accounting information.

Financial ratios can help describe the financial condition of an organization, the efficiency of its activities, its comparable profitability, and the perception of investors as expressed by their behavior in financial markets. Ratios often permit an analyst or decision maker to piece together a story about where an organization has come from, its current condition, and its possible future. In most cases, the story is incomplete, and important questions may remain unanswered.

Even though the analyst or decision maker is better informed as a result of doing the ratio analysis, the indiscriminate use of financial ratios can be extremely dangerous. Decision rules that rely on a specific or minimum value of a ratio can easily lead to missed opportunities or losses. Even the best ratio is not always indicative of the health, status, or performance of an organization. Ratios between apparently similar measurements in financial statements may be affected by differences in accounting classifications or by deliberate manipulation.

The ease with which ratios can be manipulated and the danger in using them as criteria lead many analysts to concentrate on trends in ratio measurements rather than on the absolute value or proportion expressed by the ratio itself. When a trend in the value of a ratio between financial attributes is observed, questions can be raised about why the trend is occurring. The answers to such questions provide new information, not necessarily contained in financial reports, but perhaps highly relevant and useful to the decision maker and the problem at hand.

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Similarly, comparisons of firms only on the basis of ratios can lead to erroneous conclusions. The diversity inherent in available accounting practices and principles can lead to differences in ratios between organizations being compared. Comparisons between companies can be made, but they must be made with care and with full attention to the underlying differences in basic accounting methods used in the reports as well as in the companies themselves. With these cautions in mind, we can proceed to examine briefly some commonly used financial ratios.

## *Profitability Ratios*

Profitability ratios seek to associate the amount of income earned with either the amount of resources used or the amount of activity that has taken place. These correspond to efficiency measures often used in economic and engineering theory. Ideally, the firm should produce as much income as possible with a given amount of resources or a satisfactory amount of income using as few resources as possible.

## *Return on Investment (ROI)*

Dividing net income by the amount of investment expresses the idea of economic efficiency. Return on assets (ROA), return on investment capital (ROIC), and return on owners' equity (ROE) are all used in financial analysis as measures of the effectiveness with which assets have been employed.

Return on assets (ROA) relates net income to the investment in all of the financial resources at the command of management. It is most useful as a measure of the effectiveness of resource utilization without regard to how those resources have been obtained and financed. The formula for this ratio is:

$$\text{Return on Assets (ROA)} = \frac{\text{Income}}{\text{Assets}}$$

The consolidated statement of earnings, consolidated balanced sheets, and consolidated statements of cash flows for the Gillette Company and Subsidiary Companies (hereafter the Gillette Company) are shown in **Exhibit 1**. These financial statements will be used as a basis for illustrating the calculation of each financial ratio in this introduction. For 2003 return on assets for the Gillette Company was:

$$\text{Return on Assets (ROA)} = \frac{\$1{,}385}{\$9{,}955} = 13.9\%$$

Return on invested capital (ROIC) relates all net income to all resources committed to the firm for long periods of time. It is calculated by dividing net income by the total amount of noncurrent liabilities and stockholders' equity. The formula for this ratio is:

$$\text{Return on Invested Capital (ROIC)} = \frac{\text{Net Income}}{\text{Total Liabilities and Stockholders' Equity - Current Liabilities}}$$

Return on invested capital in 2003 for the Gillette Company was:

$$\text{Return on Invested Capital (ROIC)} = \frac{\$1{,}385}{\$9{,}955 - \$3{,}658} = 22.0\%$$

Two variations in these two ratios are often observed. Because their purpose is to compare how efficiently a pool of capital has been used—a pool that includes long-term debt as well as stockholders' equity—the after-tax interest expense is often added back to income in the numerator. This can be easily calculated by the formula:

$$\text{Interest expense} \times (1 - \text{tax rate}) = \text{After-tax interest expense}$$

The amount of the adjustment is the net interest cost. Interest expense is tax deductible, and the formula calculates the after-tax interest expense by multiplying the total interest expense by the complement of the tax rate. The rationale for this adjustment is that it is a better measure of the income flow generated by management, considering all of the sources of long-term financing it has chosen to use. Without the adjustment, the income understates the earnings generated by the total pool of capital.

A second variation is appropriate when the amount of assets or invested capital is changing. Since income is earned over a period of time, the appropriate denominator in the two ratios above is probably average assets or average invested capital. This is easily approximated by adding the beginning and ending measurements together and dividing by two. The analyst has to decide if these refinements to the ratios will improve his or her ability to answer the questions at hand.

Return on equity (ROE) relates net income to the amount invested by stockholders. It is a measure of the efficiency with which the stockholders' investment through their original capital contributions and earnings retained in the business have been used. The formula for this ratio is:

$$\text{Return on Equity (ROE)} = \frac{\text{Net Income}}{\text{Stockholders' Equity}}$$

Return on equity in 2003 for the Gillette Company was:

$$\text{Return on Equity (ROE)} = \frac{\$1{,}385}{\$2{,}224} = 62.3\%$$

Note that for this ratio stockholders' equity is the correct denominator because the ratio is an attempt to understand what the investment by the owners alone has earned. (For Gillette, the return on equity is higher than other companies often report, because Gillette has been buying its own stock, called treasury stock, for several years.)

## *Earnings per Share (EPS)*

Because corporations have many owners, not all of whom own an equal number of shares, it is quite common to express earnings of a company on a per-share basis for those who wish to calculate their proportional share of earnings. The calculation of earnings per share can be complicated if there is more than one class of ownership, each with differing claims against the income of the firm. Preferred stock or other securities that are convertible into common shares are often treated as common stock equivalents in making this calculation. In published financial reports, this ratio is required to be presented, often in several variations such as "basic" or "diluted" (a very conservative form) EPS. Although the actual formulas for EPS are usually very complex, a simplified formula showing the basic common elements is:

$$\text{Earnings per Share (EPS)} = \frac{\text{Net Income - Preferred Stock Dividends}}{\text{Number of Shares of Common Stock + Equivalents}}$$

Net earnings per share for the Gillette Company for 2003 were $1.35.

### *Profit Margin*

This ratio, which gives a rate of return on sales, relates two statement of income measurements to each other. For this reason, it is not a measure of efficiency, but instead, gives some indication of the sensitivity of income to price changes or changes in cost structure. The formula for this ratio is:

$$\text{Net Profit} = \frac{\text{Net Income}}{\text{Net Sales}}$$

It is important to note that neither a high nor low profit margin necessarily means good performance. A company with a high profit margin but high investment may not be returning a great amount to investors. A firm with a very low profit margin may have required only a very small investment so that it proves highly profitable to those who invest in it.

The profit margin in 2003 for Gillette was:

$$\text{Net Profit} = \frac{\$1,385}{\$9,252} = 15.0\%$$

### *Activity Ratios*

Activity ratios provide an indication of how well assets are utilized by the organization. Efficiency in using assets minimizes the need for investment by lenders or owners. Activity ratios provide measurements of how well assets or capital are being utilized.

### *Asset Turnover*

This ratio measures the company's effectiveness in utilizing all of its assets. The formula for this ratio is:

$$\text{Asset Turnover} = \frac{\text{Net Sales}}{\text{Total Assets}}$$

For the Gillette Company in 2003, the asset turnover was:

$$\text{Asset Turnover} = \frac{\$9,252}{\$9,955} = .929$$

Since different industries require very different asset structures, comparing asset turnover ratios from one industry to those in another is potentially meaningless and must be done with caution. Likewise, when an organization participates in many industries, the exact meaning of an asset

turnover ratio can be obscured, and the most valid comparisons of an asset turnover ratio at one date may be to that of the same firm at another recent date.

Asset turnover ratios can be calculated for any group of assets. Accounts receivable, inventory, and total working capital are all asset classifications for which comparison of turnover is potentially interesting and important.

### *Days' Receivables*

Evidence about the amount of time that lapses between sales and receipt of payment from customers can be important information about the financial structure of a company. An approximation of the number of days that elapse can be obtained by dividing the amount of accounts receivable (and notes receivable if these are related to customer accounts) by the average day's sales. In cases where cash sales are a significant portion of the total, the amount of charge sales must be estimated for use in judging the length of collection.

The collection period for accounts receivable can be calculated by first dividing net sales by 365 days to determine average sales per day.

$$\text{Average Day's Sales} = \frac{\text{Net Sales}}{365}$$

Then calculate the collection period using the following formula:

$$\text{Day's Receivables} = \frac{\text{Accounts Receivable}}{\text{Average Day's Sales}}$$

Days' receivables in 2003 for the Gillette Company was:

$$\text{Average Day's Sales} = \frac{\$9{,}252}{365} = \$25.3 \text{ million}$$

$$\text{Day's Receivables} = \frac{\$920}{\$25.3} = 36 \text{ days}$$

### *Inventory Turnover*

Determining the number of times that inventory is sold during the year provides some measure of its liquidity and the ability of the company to convert inventories to cash quickly if that were to become necessary. When turnover is slow, it may indicate that inventories are not a liquid asset and suggest they should be excluded from that category for analytical purposes. On the other hand, when turnover is quite rapid, that is when inventory is sold several times each year, the liquid character of inventory can provide funds if needed in the short term and may protect the firm against inventory obsolescence.

Inventory turnover is calculated by dividing the cost of goods sold by the inventory cost. The average inventory for the year should be calculated or approximated if there has been a significant change in inventory cost from the beginning to the end of the period. Usually it is sufficient simply to add the beginning and ending inventory amounts and to use one-half of that total as the average

inventory for the year. Once the inventory turnover is determined, it can be converted to days' inventory by dividing inventory turnover into 365 days.

$$\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

$$\text{Inventory Turnover Period in Days} = \frac{365}{\text{Inventory Turnover}}$$

In some financial reports issued for stockholders, the cost of goods sold is not revealed. In these cases, it is necessary to use sales as the numerator of the ratio, which gives the appearance of providing faster inventory turnover. If the relationship between price and cost does not change, the trend in turnover period would be approximately the same between two periods. Nevertheless, it is wise to use the ratio of sales to inventory with somewhat greater care.

Inventory turnover in 2003 for the Gillette Company was:

$$\text{Inventory Turnover} = \frac{\$3{,}708}{(\$1{,}094 + \$928) \div 2} = 3.6$$

$$\text{Days' Inventory} = \frac{365}{3.6} = 100 \text{ days}$$

### *Working Capital Turnover*

Working capital turnover is a measure of the speed with which funds are provided by current assets to satisfy current liabilities. The formula for this ratio is:

$$\text{Working Capital Turnover} = \frac{\text{Net Sales}}{\text{Average Current Assets} - \text{Average Current Liabilities}}$$

Working capital turnover in 2003 for the Gillette Company was:

$$\text{Working Capital Turnover} = \frac{\$9{,}252}{(\$3{,}723.5 - \$3{,}573.0)} = 61.5\text{x}$$

### *Solvency and Leverage Ratios*

When an organization is unable to meet its financial obligations, it is said to be insolvent. Because insolvency leads to organizational distress, or even to bankruptcy or organization extinction, ratios to test solvency are often used by investors and creditors. By measuring a company's ability to meet its financial obligations as they become current, solvency ratios give an indication of the liquidity of the company.

## *Current Ratio*

This ratio is commonly used for testing liquidity or solvency. The formula for this ratio is:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

The size of the current ratio that a healthy company needs to maintain is dependent upon the relationship between inflows of cash and the demands for cash payments. A company that has a continuous inflow of cash or other liquid assets, such as a public utility or taxi company, may be able to meet currently maturing obligations easily despite the fact that its current ratio may be small. On the other hand, the manufacturing firm with a long product development and manufacturing cycle may need to maintain a larger current ratio.

The current ratio at the end of 2003 for the Gillette Company was:

$$\text{Current Ratio} = \frac{\$3{,}650}{\$3{,}658} = 1.0$$

## *Acid Test Ratio*

In cases where there is a desire or a need to confirm the absolute liquidity of an organization, the current ratio is modified by eliminating from current assets all that cannot be liquidated on very short notice. Typically, then, this ratio consists of the ratio of so-called "quick" assets (cash, marketable security, and some forms of accounts receivable) to current liabilities.

$$\text{Acid Test Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

For 2003, add the cash, short-term investments, and receivables to calculate the acid test ratio for the Gillette Company.

$$\text{Acid Test Ratio} = \frac{\$1{,}952}{\$3{,}658} = .53$$

## *Debt Ratio*

The degree to which the activities of a company are supported by liabilities and long-term debt as opposed to owner contributions is referred to as leverage. A firm that has a high proportion of debt to stockholder contributions would be referred to as being highly leveraged. The advantage to the owners of the firm of having high debt is that profits earned after payment of interest accrue to a smaller group of owners. On the other hand, when a firm is highly leveraged, risk rises when profits and cash flows fall. A company can be forced to the point of insolvency by the cost of interest on the debt.

The debt ratio is widely used in financial analysis because it reveals the effect of financial leverage. The debt ratio is calculated in different ways, and we will illustrate two here. First,

$$\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

Alternatively, the debt-to-equity ratio is sometimes calculated by dividing total liabilities by the amount of stockholders' equity. The formula for this ratio would be:

$$\text{Debt - to - Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Owners' Equity}}$$

Care must be taken in interpreting either of these ratios because there is no absolute level that can be referred to as being better than another. In general, as the ratio increases in size, returns to owners are higher but so also is risk higher. The trend in this ratio may reveal important management decisions about the financing of activities comparing two organizations. Differences in the size of the ratio may reveal management attitude toward risks and alternative strategies toward financing the activities of the respective entities.

Using the second of the two formulas above, the 2003 debt-to-equity ratio for the Gillette Company was:

$$\text{Debt - to - Equity Ratio} = \frac{\$9{,}955 - \$2{,}224}{\$2{,}224} = 3.5$$

### *Times Interest Earned*

Almost every firm has continuing commitments that must be met by future flows if the company is to remain solvent. Interest payments are an example of such commitments. The common ratio that measures the ability of a company to meet its interest payments is times interest earned. The formula for this ratio is:

$$\text{Times Interest Earned} = \frac{\text{Pretax Operating Income} + \text{Interest Expense}}{\text{Interest}}$$

The number of times interest payments are covered by current earnings offers some measure of the degree to which income could fall without causing insolvency in this account. In many cases, this is not so much a test of solvency as a test of staying power under adversity. Times interest earned for 2003 for the Gillette Company was:

$$\text{Times Interest Earned} = \frac{\$1{,}964 + \$54}{\$54} = 37.4\text{x}$$

### *Market-Related and Dividend Ratios*

Two ratios are affected by the market price for shares of ownership in corporations. These are the price earnings ratio and the dividend yield ratio. In addition, analysts sometimes calculate a dividend

payout ratio as a measure of the degree to which the firm is likely to be able to continue its dividend payments provided there is fluctuation in future income.

### *Price Earnings Ratio (PE)*

The relationship of the market price of shares of stock to the earnings of the company is of great interest to investors. Companies that are growing rapidly and are thought to have good potential for future growth often find that their shares are traded at a multiple of earnings per share much higher than companies thought to have less promise. The price earnings ratio is often included in stock market tables in investment information prepared by analysts. The formula for this ratio is:

$$\text{Price Earnings Ratio (PE)} = \frac{\text{Market Price per Share of Stock}}{\text{Earnings per Share}}$$

Since the market price of shares frequently fluctuates, this ratio is sometimes calculated using an average market price for a period of time. If the average price of a share of Gillette stock in 2003 was $34.00, the price earnings ratio would have been 25.2%.

$$\text{2003 Price Earnings Ratio} = \frac{\$34.00}{\$1.35} = 25.2$$

### *Dividend Yield Ratio*

The dividend yield to common shareholders is dependent upon the market price originally paid for the share and is calculated by dividing dividends received by the market price originally paid for the shares. For a prospective investor, dividend yield is the dividend per share divided by the current market price of the stock.

$$\text{Dividend Yield} = \frac{\text{Dividends per Share}}{\text{Market Price per Share}}$$

If the market price of shares in the Gillette Company was $34.00, the dividend yield in 2003 when dividends per share of $.65 were paid to shareholders would have been:

$$\text{Dividend Yield} = \frac{\$.65}{\$34.00} = 1.9\%$$

### *Dividend Payout*

The dividend payout ratio shows the proportion of net income that was paid in dividends. Both the dividend yield and dividend payout ratio are useful for forecasting future dividend streams to investors in the company's common stock. The formula for this ratio is:

$$\text{Dividend Payout} = \frac{\text{Dividends}}{\text{Net Income (available to common shareholders)}}$$

For the Gillette Company in 2003, dividends paid to common stockholders totaled $666.0 million; therefore the dividend payout was:

$$\text{Dividend Payout} = \frac{\$666}{\$1{,}385} = 48\%$$

## *Using Ratios to Think about Management Strategies*

Sometimes it is useful when conducting a financial analysis to think about the interrelationships between ratios and to use them to think about the strategies that management has adopted or might adopt. One well-known algebraic construction using ratios is known as the du Pont model because financial analysts at the E. I. du Pont de Nemours & Co. are credited with its development and use during the 1920s. The du Pont model multiplies profit margin times asset turnover times a ratio of assets over equity to calculate return on stockholders' equity. If we look at this algebraic construction, we can see why it is so useful.

$$\frac{\text{Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Assets}} \times \frac{\text{Assets}}{\text{Owners' Equity}} = \text{Return on Owners' Equity}$$

The first ratio, profit margin, can be used to focus management's attention on the relationship between the price and cost of products or services sold. The second ratio, asset turnover, emphasizes the efficient use of resources in producing products and services. The third ratio, assets over equity, focuses on the ability of management to leverage the firm properly to provide maximum return to stockholders. Each of these major classes of decisions that managers must make can be examined in light of its ability to provide the overall objective of increasing return to stockholders.

## *Common Size Financial Statements*

In order to examine the changing financial structure of a firm through time and the changing nature of operations, many analysts like to create common size financial statements in which the balance sheet and the statement of income are prepared in the percentage format. In a common size balance sheet, each asset, liability, and owners' equity amount is expressed as a percentage of total assets. In a common size statement of income, sales is set at 100%, and each item is expressed as a percentage of sales.

Common size financial statements facilitate the comparison of firms of a different size as well. Although firms may be in the same industry, they may be of significantly different sizes, and common size statements allow an analyst to focus on the efficiency with which managements of different firms have created a capital structure and have achieved efficient operations.

Common size balance sheets and statements of income for the Gillette Company are presented in **Exhibit 2**.

**Exhibit 1** The Gillette Company and Subsidiary Companies—Consolidated Statement of Income for Years Ended December 31, 2003, 2002, and 2001 (dollars in millions, except per share amounts)

| | Year Ended December (millions, except per share amounts) | | |
|---|---|---|---|
| | 2003 | 2002 | 2001 |
| Net Sales | $9,252 | $8,453 | $8,084 |
| Cost of Sales | 3,708 | 3,511 | 3,407 |
| Gross Profit | 5,544 | 4,942 | 4,677 |
| Selling, General, and Administrative Expenses | 3,541 | 3,172 | 3,007 |
| Restructuring, Asset Impairment and Other | -- | (39) | 172 |
| Profit from Operations | 2,003 | 1,809 | 1,498 |
| **Nonoperating Charges (Income)** | | | |
| Interest income | (12) | (25) | (4) |
| Interest expense | 54 | 84 | 145 |
| Other charges (income)—net | (3) | (2) | 15 |
| | 39 | 57 | 156 |
| Income from Continuing Operations before Income Taxes | 1,964 | 1,752 | 1,342 |
| Income Taxes | 589 | 543 | 432 |
| Income from Continuing Operations | 1,375 | 1,209 | 910 |
| Income from Discontinued Operations, net of tax | 10 | 7 | -- |
| Net Income | $1,385 | $1,216 | $910 |
| **Net Income Per Common Share, Basic** | | | |
| Continuing Operations | $1.35 | $1.15 | $.86 |
| Discontinued Operations | .01 | -- | -- |
| Net Income | $1.36 | $1.15 | $.86 |
| **Net Income Per Common Share, Assuming Full Dilution** | | | |
| Continuing Operations | $1.34 | $1.14 | $.86 |
| Discontinued Operations | .01 | .01 | -- |
| Net Income | $1.35 | $1.15 | $.86 |
| Adjusted Net Income, assuming the adoption of SFAS 142 for 2001 | $1,385 | $1,216 | $934 |
| Adjusted Net Income per Common Share, assuming the adoption of SFAS 142 for 2001 | | | |
| Basic | $1.36 | $1.15 | $.89 |
| Assuming full dilution | $1.35 | $1.15 | $.88 |
| Weighted average number of common shares outstanding | | | |
| Basic | 1,021 | 1,055 | 1,055 |
| Assuming full dilution | 1,024 | 1,059 | 1,058 |

**Exhibit 1 (continued)** The Gillette Company and Subsidiary Companies—Consolidated Balance Sheets, December 31, 2003 and 2002 (dollars in millions except per share amounts)

| At December 31 | 2003 | 2002 |
|---|---|---|
| **Assets** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 681 | $ 801 |
| Trade receivables, less allowances: 2003—$53; 2002—$73 | 920 | 1,202 |
| Other receivables | 351 | 311 |
| Inventories | 1,094 | 928 |
| Deferred income taxes | 322 | 380 |
| Other current assets | 282 | 175 |
| Total current assets | 3,650 | 3,797 |
| Property, plant and equipment, net | 3,642 | 3,565 |
| Goodwill | 1,023 | 962 |
| Intangible assets, net | 496 | 400 |
| Other assets | 1,144 | 1,139 |
| Total assets | $9,955 | $9,863 |
| **Liabilities and Shareholders' Equity** | | |
| **Current Liabilities** | | |
| Loans payable | $ 117 | $ 673 |
| Current portion of long-term debt | 742 | 527 |
| Accounts payable and accrued liabilities | 2,506 | 2,054 |
| income taxes | 293 | 234 |
| Total current liabilities | 3,658 | 3,488 |
| Long-term debt | 2,453 | 2,457 |
| Deferred income taxes | 626 | 692 |
| Other long-term liabilities | 929 | 920 |
| Minority Interest | 65 | 46 |
| **Stockholders' Equity** | | |
| Common stock, par value $1 per share | | |
| Authorized: 2,320 shares | | |
| Issued 2003—1,374 shares; 2002—1,370 shares | 1,374 | 1,370 |
| Additional paid-in capital | 1,273 | 1,197 |
| Earnings reinvested in the business | 7,333 | 6,608 |
| Accumulated other comprehensive loss | (1,088) | (1,523) |
| Treasury stock, at cost | | |
| 2003—367 shares; 2002—326 shares | (6,665) | (5,392) |
| Deferred stock-based compensation | (3) | -- |
| Total stockholders' equity | 2,224 | 2,260 |
| Total liabilities and stockholders' equity | $9,955 | $9,863 |

**Exhibit 1 (continued)** The Gillette Company and Subsidiary Companies—Common Size Balance Sheets, December 2003 and 2002 (%)

| At December 31 | 2003 | 2002 |
|---|---|---|
| **Assets** | | |
| **Current Assets** | | |
| Cash and cash equivalents | 6.8 | 8.1 |
| Trade receivables, less allowances: 2003—$53; 2002—$73 | 9.2 | 12.2 |
| Other receivables | 3.5 | 3.2 |
| Inventories | 11.0 | 9.4 |
| Deferred income taxes | 3.2 | 3.9 |
| Other current assets | 2.8 | 1.8 |
| Total current assets | 36.5 | 38.6 |
| Property, plant and equipment, net | 36.6 | 36.1 |
| Goodwill | 10.3 | 9.8 |
| Intangible assets, net | 5.0 | 4.1 |
| Other assets | 11.5 | 11.5 |
| Total assets | 100.0 | 100.0 |
| **Liabilities and Shareholders' Equity** | | |
| **Current Liabilities** | | |
| Loans payable | 1.2 | 6.8 |
| Current portion of long-term debt | 7.5 | 5.3 |
| Accounts payable and accrued liabilities | 25.2 | 20.8 |
| income taxes | 2.9 | 2.4 |
| Total current liabilities | 36.8 | 35.3 |
| Long-term debt | 24.6 | 24.9 |
| Deferred income taxes | 6.3 | 7.0 |
| Other long-term liabilities | 9.3 | 9.3 |
| Minority Interest | .7 | .5 |
| **Stockholders' Equity** | | |
| Common stock, par value $1 per share | | |
| Authorized: 2,320 shares | | |
| Issued 2003—1,374 shares; 2002–1,370 shares | 13.8 | 13.9 |
| Additional paid-in capital | 12.8 | 12.1 |
| Earnings reinvested in the business | 73.7 | 67.0 |
| Accumulated other comprehensive loss | (10.9) | (15.4) |
| Treasury stock, at cost | | |
| 2003—367 shares; 2002—326 shares | (67.0) | (54.7) |
| Deferred stock-based compensation | 0.0 | 0.0 |
| Total stockholders' equity | 23.3 | 22.9 |
| Total liabilities and stockholders' equity | $100.0 | $100.0 |

Note: Columns do not add because of rounding.

**Exhibit 1 (continued)** The Gillette Company and Subsidiary Companies—Consolidated Statements of Cash Flows for Years Ended December 31, 2003, 2002, and 2001 (dollars in millions)

| Years Ended December 31 | 2003 | 2002 | 2001 |
|---|---|---|---|
| **Operating Activities** | | | |
| Income from continuing operations | $1,375 | $1,209 | $910 |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities: | | | |
| Restructuring and asset impairment charge (recovery) | -- | (9) | 172 |
| Depreciation and amortization | 578 | 500 | 509 |
| Funding of company pension loans | (72) | (525) | (35) |
| Pension expense | 143 | 70 | 46 |
| Deferred income taxes | (49) | 162 | 45 |
| Other | 7 | 8 | (18) |
| Changes in assets and liabilities, excluding effects of acquisitions and divestitures: | | | |
| Accounts receivable | 286 | 364 | 622 |
| Inventories | (43) | 123 | 101 |
| Accounts payable and accrual liabilities | 334 | 188 | (191) |
| Other working capital items | 38 | (137) | (20) |
| Other noncurrent assets and liabilities | 43 | 124 | (49) |
| Net cash provided by operating activities | 2,640 | 2,077 | 2,092 |
| **INVESTING ACTIVITIES** | | | |
| Additions to property, plant and equipment | (408) | (405) | (624) |
| Disposals of property, plant and equipment | 45 | 43 | 59 |
| Acquisition of business, net of cash acquired | (161) | -- | -- |
| Other | 6 | -- | 1 |
| Net cash used in investing activities | (518) | (362) | (564) |
| **FINANCING ACTIVITIES** | | | |
| Purchase of treasury stock | (1,273) | (427) | (12) |
| Proceeds from sale of put options | -- | 15 | 9 |
| Proceeds from exercise of stock option and purchase plans | 80 | 57 | 53 |
| Proceeds from long-term debt | 709 | 1,174 | 525 |
| Repayment of long-term debt | (534) | (458) | (684) |
| Increase (decrease) in loans payable | (567) | (1,565) | 56 |
| Dividends paid | (666) | (685) | (686) |
| Settlements of debt-related derivative contracts | 1 | 45 | 4 |
| Net cash used in financing activities | (2,250) | (1,844) | (735) |
| Effect of Exchange Rate Changes on Cash | 8 | 5 | (1) |
| Net Cash Provided (Used) by Discontinued Operations | -- | (22) | 93 |
| Increase (Decrease) in Cash and Cash Equivalents | (120) | (146) | 885 |
| Cash and Cash Equivalents at Beginning of Year | 801 | 947 | 62 |
| Cash and Cash Equivalents at End of Year | $681 | $801 | $947 |
| Supplemental disclosure of cash paid for: | | | |
| Interest | $59 | $83 | $154 |
| Income taxes | $563 | $345 | $232 |

**Exhibit 2** The Gillette Company and Subsidiary Companies—Common Size Statement of Income for Years Ended December 31, 2003, 20021, and 2001 (%)

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Net Sales | 100.0 | 100.0 | 100.0 |
| Cost of Sales | 40.1 | 41.5 | 42.1 |
| Gross Profit | 59.9 | 58.5 | 57.9 |
| Selling, General, and Administrative Expenses | 37.3 | 37.5 | 37.2 |
| Restructuring, Asset Impairment and Other | -- | (.5) | 2.1 |
| Profit from Operations | 22.6 | 21.5 | 18.6 |
| Nonoperating Charges (Income) | | | |
| Interest income | (.1) | (.3) | 0 |
| Interest expense | .6 | 1.0 | 1.8 |
| Other charges (income)—net | 0 | 0 | .2 |
| | .4 | .7 | 1.9 |
| Income from Continuing Operations before Income Taxes | 21.2 | 20.7 | 16.6 |
| Income Taxes | 6.4 | 6.4 | 5.3 |
| Income from Continuing Operations | 14.9 | 14.3 | 11.3 |
| Income from Discontinued Operations, net of tax | .1 | 0 | 0 |
| Net Income | 15.0 | 14.3 | 11.3 |

Note: Columns do not add because of rounding.