Sports fashion retail finacial assessment essay sample

Finance, Market

The purpose of this report is to advise a potential investor into spending his money in JD Sports Company. It looks into the financial strengths and weaknesses of JD Sports and Sports Direct, taking into consideration the retail industry, swot analysis, and macroeconomics factors affecting JD Sports and Sports Direct and Key Financial Ratios. The financial strength of JD Sports and Sports Direct gives them the financial power expand their businesses, economies of scale give Sports Direct maximum cost advantage over JD Sports, online market as well as m-commerce provides JD Sports the opportunity to grow its business globally.

The current economic downturn, along with the increase of youth unemployment poses a greater threat to JD Sports who have a dedicated business segment to the youth as compared to Sports Direct. On review of both Sports Direct & JD Sports, ROE is the same although it has fallen 3% in the period both companies have been looking to increase their market share after the demise of JJB sports. " Sports Direct reported a 13. 8 per cent sales increase in its third quarter, showing how the company is winning market share from JJB Sports". (Financial Times, 2012). Our outlook on investment would be with JD Sports given that JD have a 5 year dividend growth rate of 28. 58% and their EPS indicates a better rate of return on investment.

INTRODUCTION

Retail industry in UK is one of the important sectors of the economy, contributing a total of 8% to the UK economy alone (DBIS, 2012). Although the current economic crisis has made retail trading very difficult, UK retailers are amongst the world's top performing companies, the UK also attracts many global brands setting up flagship stores to attract both domestic and overseas visitors to prime retail locations across the UK (DBIS, 2012). This report looks into the financial strengths and weaknesses of JD Sports and Sports Direct In an attempt to recommend and guide a potential investor, this report considers the following points below: 🎬 🎬 🎬 🎬 Retail industry as a whole in UK Macroeconomics factors affecting JD Sports and Sports Direct SWOT analysis for both JD Sports and Sports Direct Key Financial Ratios

INDUSTRY

Retail sales give an indication about the performance of the economy and also the spending power of the consumers. UK retail is currently going through difficult trading because of global but more importantly euro zone crisis. Latest report from Bloomberg shows that there has been a general decline in the UK retail sales in October especially on food and clothing (Bloomberg, 15th November 2012) Clothing retail which accounts for 12% of total retailing market fell by 2. 3% in October although there was a surge in September by 1. 9%. The recent autumn statement by George Osborne fails to give any glimmer of hope in the retail industry as the economy is predicted to remain the same or increase to 1% depending on who one listens to.

MACROECONOMICS OF INDUSTRY

Economic crisis leading to Unemployment

The unemployment rate of a country reveals the weakness or shape of the economy. Recent data from the office of national statistics (ONS) shows that there were 29. 58 million people unemployed aged 16 and over by June

2012. Current youth unemployment rate of 21% (Guardian, 2012) which is a key demographic for this sector indicates the UK public have less spending ability.

GDP growth

The recent autumn statement from the Chancellor as well as from ONS shows very little or insignificant GDP growth of 1%. Confirming that the retail industry has not recovered from the recession. (The Telegraph 2012) " Although the underlying economy appears to be recovering, the general retailers potentially face a nasty combination of external macroeconomic pressures and internal structural challenges the most immediate pressures on the sector being the increase in VAT and rises in raw material costs. (The Telegraph 2012).

Wages

The current euro zone crisis as well as the slow growth of the economy means that companies are barely able to pay their workers let alone increase their wages despite the increase of goods. Amongst the youth, recent figures from poverty. org. uk shows that over 3 million employed youth were earning less than £7 an hour. This leaves no room for any disposal income as customers move from been extravagant in their spending to been frugal.

SWOT ANALYSIS

Strengths

The financial strength of JD Sports and Sports Direct gives them the financial power expand their businesses, buying and merging with other companies as well as pursuing new markets as evidenced by the recent acquisition of Blacks, Firetrap and JJB stores. Economies of scale give Sports Direct maximum cost advantage over JD Sports as they are able to buy in bulk. Wide products offerings are a strength both companies have as they are able to appeal to all kinds of customers.

Weaknesses

The result of more acquisitions and mergers means that both companies have a high wage budget which is a drain in their finances. Although both companies have acquired and merged with some companies and brands, not all are recognised or valued by customers. The relatively weak online presence by JD Sports as compared to Sports Direct means it is missing out the opportunity to sell to more potential customers.

Opportunities

The online market as well as m-commerce provides JD Sports the opportunity to grow its business globally. Sports Direct seems to be a step ahead with its new online site. The sales of companies own brands in this current economic climate are an opportunity for both companies to retain their customers who would otherwise look somewhere else. Opening of branches in other countries as well as the acquisition of some international brands gives both companies the opportunity to expand and increase their sales. The segmentation of JD Sports business into four parts gives it a great opportunity to spread out its products and services in order to expand its business as compared to Sports Direct which is yet to fully develop that aspect of their business.

Threats

The current economic downturn has affected both JD Sports and Sports Directs businesses. The chancellors’ autumn statement further predicts a gloom on the economy. The high increase of youth unemployment poses a greater threat to JD Sports who have a dedicated business segment to the youth as compared to Sports Direct. Intense competition from general clothing retailers who now sell cheap sporting fashion products attract more customers.

Financial ratio analysis is a commonly used technique by companies and investors to evaluate the financial health of ether their own company or one they are looking to invest into. It is therefore best to have two data sets to compare against. Gross Profit = Sales Revenue – Cost of Goods Sold: Company Sports Direct JD Sports Figure 3 Appendix C 2011 41. 20% 49. 45% 2012 40. 54% 49. 16%

This ratio represents a company’s ability to turn sales revenue into profits maximising those profits by keeping cost of sales down. It is clear to see that both companies have had a marginal drop in gross margin, this could be contributed to a number of reasons, drop in footfall affecting sales directly, increase in operating costs pushing up cost of sales, Data from the Office for National Statistics (ONS) showed retail sales volumes fell in 2012 (Daily mail, 2012) Operating Profit Margin = Operating Income/Sales Revenue: Company Sports Direct JD Sports Figure 4 Appendix C 2011 0. 08 0. 09 2012 0. 09 0. 06

Operating profit, earnings before income and taxes (EBIT) is the income that is left, after operating costs, overheads, expense costs and costs of goods sold, are subtracted out. The ratios indicate that Sports Directs operating

Profit has decreased in the year this may be due to a slowdown in sales or the several recent acquisitions and mergers, on comparison JD Sports has increased possibly through optimisation and fewer acquisitions, despite pressures on margin and rising taxes and other levies across Europe, full-year profit before tax should come within expectations of £65-£70m. (Mouls, J., 2012) ROE = Net income after tax / Shareholder's equity: Company Sports Direct JD Sports Figure 5 Appendix C 2011 25% 25% 2012 22% 22%

Return on Equity correlates company's profit to shareholder equity, as it considers retained earnings, it indicates to investors how capital is re-invested, measuring the bottom line performance. A high ROE could mean the company could generate cash to finance projects or acquisitions without bank funding. On review of both Sports Direct & JD Sports, ROE is the same although it has fallen 3% in the period both companies have been looking to increase their market share after the demise of JJB sports. " Sports Direct reported a 13. 8

per cent sales increase in its third quarter, showing how the company is winning market share from JJB Sports”. (Financial Times, 2012). Current Ratio = Current Assets / Current Liabilities: Company Sports Direct JD Sports Figure 6 Appendix C 2011 1. 29 1. 45 2012 1. 44 1. 18

The current ratio indicates a company’s financial strength and its ability to meet its current financial obligations within one financial year. Liquidity of a business is usually of interest to its short-term creditors because it indicates that the company can meet its liabilities, should this number be below 1 it would give cause for concern. Sport Direct’s current ratio has increased by 0. 15 this may be due to the company increasing its cash holding or financial leveraging, JD Sports has decreased by 0. 27 this is a sharp drop although not below 1, lack of liquidity may hamper growth, Price Earnings = Share Price/Earnings Per Share: Company Sports Direct JD Sports Figure 7 Appendix C 2011 16. 83 5. 43 2012 23. 06 7. 53

Price Earnings ratio shows how much investors are willing to pay for shares in the company, high PE often means the company is carrying a lot of risk, low PE could indicate the share price is undervalued. Sports Direct have been able to increase their PE, buy increasing their market share and investing in online retail they have given the market confidence in their abilities. JD Sports low ratios could be because customers are tentative about the acquisition of Blacks Leisure hence the low price. Earnings per share = Net Profit/Number of Shares: Company Sports Direct JD Sports Figure 8 Appendix C 2011 14. 80 114. 84 2012 18. 68 96. 27

Earnings per share tell investors how much they have earned on their investment. When looking that the EPS you need to consider the current share price, Sports Direct is 399. 00 and JD Sports is 740. 00. Although Sports Direct have increased their EPS it is clear that JD Sports, despite the fall, has a better rate of return on investment, allowing the investor to recoup his investment quicker. Quick ratio = Current Assets excluding inventories/Equity-long term borrowings * 100 Company Sports Direct JD Sports Figure 9 Appendix C 2011 0. 53 0. 87 2012 0. 50 0. 57

It is often said that the ideal measure is between 1. 5 and 2, any figure less than 1 is not good as the business would be unable to pay off its debt should it cease operating. Brealey (2008, 795) states regarding the quick ratio '…if trouble comes, inventories may not sell at anything above fire-sale prices… trouble typically comes because customers are not buying…'. Sports Direct's current quick ratio means it is less capable of paying off debts if it were to cease trading, when excluding their inventory. The inventories over both years is made up almost all by good for re sale which has increased from 217 to 315 million over the year, which made up about a third of their current assets. The same applies to JD Sports although it has drastically decreased in 2012. Gearing = Long-Term Borrowings/Equity plus Long-Term Borrowings * 100 Company Sports Direct JD Sports Figure 10 Appendix C 2011 37% 0. 34% 2012 31% 0. 5%

This measures to what extend the business is financed by debt so the lower the better. Sports Direct has fallen from 37% to 31%. JD Sports has gone from 0. 34 to 0. 5% probably because of its acquisitions and expansions.

Sports Direct is financed by stock, but it also has 213 m of loans and 9 m over draft. JD Sports is finance only by 1. 2 m of loans. This may explain JD Sports increasing dividend growth, compared with Sports Direct null payment. Interest Payable Company Sports Direct JD Sports Figure 11 Appendix C 2011 13 23 2012 18 14

This is how many times the net profit can be used to pay interest from loans. Both companies are high. Sports Direct has gone up from 13 to 18. JD Sports has gone down from 23-14. Trade Receivables Ratio = Trade Receivables/Cost of Sales * 365 Company Sports Direct JD Sports Figure 12 Appendix C 2011 21 15 2012 9 19

Sports Direct has fallen from 21-9 days and JD Sports has risen from 15-19 days. This was calculated by the current trade receivables*365/sales. This gives an approximation only. It does however show that there generally no problems with people paying. Trade Payables Ratio = Trade Payables/Cost of Sales * 365 Company Sports Direct JD Sports Figure 13 Appendix C 2011 91 53 2012 52 68

This is calculated in a similar way to the above, and Sports Direct has gone down from 91-52 days and JD Sports have gone up from 53-68. Interest Times Cover = Profit before deducting interest/ Interest Company Sports Direct JD Sports Figure 14 Appendix C 2011 12 22 2012

As Brealey (2009, 794) states, this is the extent to which interest is covered by earnings before interest and tax (EBIT) plus depreciation. Sports Direct has gone up in the least year from 12 to 17 times and JD Sports down from

22 to 13. Sports Directs is explained by an increase in profit, and JD Sports interest has nearly doubled by the acquisition of Blacks. Note here for this calculation on JD Sports they have also some additional interest/finance cost that they have classified as non-current, but the figure here includes only the current liabilities, and they are 5. 4 current and 1. 2 non current (million).

CONCLUSION

Sports Direct have not paid any since 2009, whereas JD have a 5 year dividend growth rate of 28. 58%, the last one giving a 3. 49% dividend yield, they also have a 3. 81 dividend cover this year, which means that they are quite able to pay this, even if they experience a fall in profit next year. They are not as concerned about debt as Sports Direct, evidenced by a gearing of 0. 5% means that they are not financed by debt, anywhere near to Sports Direct 31. 26%. However the share price over the last 16 months has a trend of decline for JD Sports (appendices?) whereas Sports Direct have managed to show an average increase for the last 4 years in share price. Sports Direct have have an earning per share of 18. 8 pence with a current share price of 404 pence, and JD EPS of 96. 27 with a current share price of 740 pence. JD Sports have a healthy Price earnings ratio of only7. 53 meaning it will take 7. 53 years for the share to pay itself back.

RECOMMENDATIONS

Having analysed some ratios above regarding both companies, this report recommends the potential investor to invest in JD Sports as compared to Sports Direct. Data shows JD Sports over the past years having a better dividend growth rate of 28. 58% as well as an increased gross margin. JD

Sports EPS indicates a better rate of return on investment as it appeals more to potential investors as compared to Sports Direct. The price earnings ratio of 7. 3 though lower than Sports Direct, is set to increase in the coming years due to its recent acquisitions of Blacks Leisure, expansion into international markets, and optimisation of its business processes.

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