Tesco annual report

[Business](), [Accounting]()

Introduction

This report will conclude the performance of Tesco Plc. over the previous 5-months. The performance will be based on the share-price performance, company reports as well as a comparison between J Sainsbury Plc, Morrison Plc, and U. S rival Wal-mart.

Price Competition

Given the currentenvironment, aggressive competition in the UK grocery market is the greatest headwind to continued growth. According to Kantar Worldpanel. Tesco continues to lose market-share as aggressive competition from discount brands Aldi and Lidl pushes greater emphasis on Tesco's marketing and price strategy to retain custom as both competitors plan major expansion plans in the coming years. To add, major price competition from the likes of ASDA and now Morrison's is gaining momentum once again. Morrison's' aggressive plan to spend GBP1bn on cutting prices over three years will put pressure on Tesco and other supermarket operators to respond in order to protect market share. This could accelerate margin erosion across the sector in 2014. Morrison's price cuts are likely to be funded by planned cost savings and potentially by accepting a lower margin. They are more aggressive than the GBP1bn initiative Asda announced in November, which at the time was to be spread over five years. To limit the impact on margins, retailers will probably respond by accelerating cost-cutting initiatives and investment in product ranges and store formats. Tesco has the strongest margin, but this has been shrinking for several years. It may now be pushed to rethink its pricing in order to defend market share, which has come under pressure as evidenced by weak 2013 Christmas trading. Furthermore, the above could dampen CAPEX plans for the coming years.

Rise of Discounters

As mentioned, the recent Kantar Worlpanel (2014) report cemented the rise of Aldi and Lidl; however recent reports from Tesco have attempted to downplay the threat, with little success. The CEO referred to them as ‘ niche’ players. However, these players control 45% of the affluent German market and are market leaders in several other large countries. We would not compare the effectiveness and the threat posed by Aldi in 2014 with that posed by Kwik Safe (disappeared) in the 1990s. It is not an informative chart in our view.

CAPEX remains strong

CAPEX guidance was cut to a maximum of 2. 5bn per annum, in line with market expectations. Tesco plans to cut new space additions in the UK to 700, 000 sq ft in 2014/15 from 1. 4mn in 2013/14. CAPEX is shifting from new space to maintenance. Having invested ? 400mn in the UK Refresh program in 2013/14, the company plans to invest 500mn per annum in each of the next three years. This is close to the total to complete the program. The priority for next year is re-modeling the Extra format where the sales performance is the weakest.

Online growth Mixed

A lot of focus, as expected, has been put on the increasing movement online. With Morrison’s considering and online platform, while Waitrose moves in with more products and free delivery. Tesco announced it will reduce the fee it charges for home delivery and click & collect. While it is good that the company aims to be competitive, excessive cuts in the delivery charge would reduce margins and also incentivize the customer to order smaller quantities more frequently, making the economics a lot less attractive.

A delivery charge is a tool used to distribute demand among the different time slots and days of the week. Tesco unveiled 127Million of trading profit from online grocery, suggesting a 5% margin. According to the company, all direct costs are fully charged, which is the cost of the pickers and the delivery. This would not include things such as store depreciation, store energy costs, rates, etc. Given this, on estimated 25 Million annual orders of 100 each, the delivery fee (4-5 per order) would account for the great majority of the profit. If this delivery fee is substantially cut, so will the profit obtain?

Share Performance

Graph – Share Price Performance of Selected Companies – 6-Month. Data obtained from Bloomberg. Focusing on share performance (Graph 1), over the previous 6-months, Tesco Plc is down by 18. 3%, however, performance is still between W. M. Morrison and J Sainsbury, whose shares have fallen by 24. 2% and 19. 9% respectively. Given this; the grocery sector has been a weak performer on the market, given that the FTSE 100 has risen by 2% over the same period. Weakness in the sector was seen on the 12th March (circled), after the market release from Kantar Worldpanel. According to Kantar Worldpanel, Tesco’s market share dropped to 28. 7% in the 12 weeks ended March 2. That compares to 29. 6% a year ago and is the lowest level since late 2004. Adding to the company's woes, Tesco's sales were down 0. 6 percent in the three-month period. The main issue for investors was the movement of these sales to discounters Aldi and Lidl, plus upmarket grocer Waitrose.

Morrison's also loosened further to a share of 11. 1% from 11. 8% a year earlier, while ASDA, a subsidiary of Wal-Mart Stores eased to 17. 5%, a 0. 3 point fall Y-O-Y. Sainsbury was the only grocer among Britain's ' big four' to hold on to its market share in the period, reaming at 17%. The report noted that the big-four were competing for more for a shrinking ' middle-ground' as consumers move to either discounters or upmarket retailers – over the past 3-years, Waitrose, Aldi, and Lidl have taken a combined 3. 5 points from the competition, equating to ? 4. 4Billion in sales per year. Taking an international look, while Wal-Mart did record a small drop on the 12th March, over the 6-month period its shares are up 3%, given its exposure to the U. S economy, which has been performing strongly, supported by consumer spending.

Summary

While the recovery in the UK economy will present opportunities for Tesco Plc, given its exposure to consumer spending through an extensive product offering, major headwinds remain as the continued expansion of discounters pose a real threat, contrary to the thoughts of Tesco management. Furthermore, the price-wars between major retailers commence once again for the shrinking middle-ground of the market, margins are expected to be hit. This has the potential to derail Tesco’s expansion plans, which will impact on a future performance given aggressive competition.

Reference

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