

Tesco and sainsbury financial analysis



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One of the highest competitive markets is food retailing as it undergoes a significant amount of pressure on cost control. The food retailers in the UK like Sainsbury's, Marks and Spencer, Tesco and Asda have faced a huge challenge due to the current climate of financial squeeze leading to job losses. This resulted in a surge of consumer confidence index. Despite the ongoing financial crisis, successful food retailers have discovered competitive anti-crisis policies (Brand Republic, 2009).

My report therefore is a comparison and financial analysis of UK'S 2 largest food retailers: Tesco plc and J Sainsbury's plc. I will utilize the ratio analysis technique to look at their financial performance, stability and profitability. The report consists of a short introduction, main body consisting of comparison based on indicators and ratios over 3 financial years 2007-2009. Finally, I'll end my report with a conclusion of their financial performance over the last 3 years.

Introduction

Tesco plc is world's third largest retailer after Wal Mart and Carrefour in terms of revenue (Tesco, 2010). It is UK based and holds the first position in the home supermarket chain. Tesco plc was established in East London by Jack Cohen in 1919 and entered London Stock Exchange (LSE) in 1974 (Tesco, 2010)

Currently, Tesco has 2, 306 stores in UK(Tesco 2010) . In 2009, Tesco plc had 30. 7% of UK's market shares and financial services and mobile have been a part of its business since 2003. Sir Terry Leah was appointed as

Tesco's CEO in 1997. Tesco employs about 440,000 people and its current market capital is in the order of excess of £33 billion (Tesco, 2010).

J Sainsbury's is UK's third largest retailer in the supermarket industry. It currently holds 16.3% of UK market shares (Sainsbury's 2010).

Tesco Stake holders

Tesco has deeply engaged itself with its stakeholders comprising of customers, investors, staff, local communities, suppliers, Government and non-government organizations (NGOs). Tesco plc aims to listen to their stakeholders to address the emerging issues. They use the feedback to review the issues on their agenda. They are planning to launch the Community Promises internationally after its UK success.

- Customer

Tesco wants the shopping experience for their customers to be great, fair and high quality. Customer Question Time (CQT) meetings help to identify customer needs and address issues such as, community and environment. They engage with customers on daily basis and CQT meetings are held in stores. Customers like to recycle and Tesco have recycling centres in six hundred stores. They have installed 64 one-stop automated machines to facilitate recycling. These recycling machines can hold waste up to 4 times greater than standard and this means saving on carbon dioxide and transport. Since the launch of green Clubcard points in August 2006, UK customers have allowed Tesco to save more than 3 billion carrier bags. Therefore, customers are using 50% lesser bags since the reward Clubcard scheme.

- Communities

Tesco has launched new Community Promises and Plan in 2009 to engage staff with communities. The aim is to provide support and initiatives for local people, create more jobs and help in the regeneration of the community. They also communicate with local people through leaflets, exhibitions, competition, events and by working with community groups.

- Staff

They engage with staff through Staff Question Time, annual viewpoint survey, face-to-face debriefing and store forums. They engage with community via exhibitions and public consultations held at stores. 70% of the staff working at Tesco plc enjoy working in the stores (Tesco plc report, 2009). Tesco want fair terms and conditions for their staff and want a safe, healthy working environment for workers. They offer rewards and benefits for their staff and are bringing bonus schemes and competitive benefits linked with profitability. In 2008, 193000 staff workers received £92 million free shares in Tesco's Shares Success Scheme

- Investors

Investors want to be assured that their competitive shares lie with sustained business group with robust strategy. They want business to be reported in a fair and open way. Thus, Tesco actively engages in meetings and conferences of their investors to understand their views on Tesco's corporate strategy. Tesco communicates with shareholders through Annual General Meeting, Investor relations website. Tesco also participates in Carbon

Disclosure Project and aims to reduce carbon emission by 50% by 2020 (Tesco report, 2009).

- Suppliers

Suppliers expect long-term opportunistic, fair and honest relationship. Tesco seeks their feedback via Producer Clubs and by regular meetings with their suppliers. 90% of suppliers quoted Tesco as reliable at on-time payments, 93% called Tesco professional and 92% said Tesco is fair in dealing (Tesco plc report, 2009). This is achieved via the supplier Viewpoint Survey conducted by Tesco since 2005. Tesco aims to identify suppliers who had difficult or unpleasant dealing with them to rectify the problem. Tesco follows the UK Supplier Code of Practice introduced in 2001.

Government and non-government organizations (NGOs)

Tesco is sharing its expert knowledge and business insight with the government in a very transparent and open manner, to shape public policies. They participate in planning processes and consultations on issues with the governments and regularly meet with NGOs to discuss issues such as, animal welfare, climate change, planning and regeneration, nutrition and ethical trading. They have in-store pharmacies, opticians to promote good health. They have Healthy Living website, leaflet and in-store information for the people. Tesco donated £57 million to charities (1.9% of pre-tax profits in 2009 (Tesco plc, 2009). They engage only in activities which are beneficial to their business, customers and employees. They contributed to the Saturated Fat and Portion size report in 2008 produced by the Institute of Grocery Distribution, IGD.

Tesco plc is aiming to get kids active and conducted Tesco Great School run in 2008 in which 750000 school children took part. Another good example is the Cancer Research UK's race for Life which raised over £40 million in the year 2008. Similar events were held in Poland, Czech and Slovakia. Tesco is also participating in delivering government's Alcohol Harm Reduction Strategy. Tesco has relations with Remploy and Shaw Trust which are disability organizations and are working positively towards developing people with disabilities.

Tesco is working actively to halve the carbon emission by 2012 by efficient use of vehicles, using alternative transport and investing in new technologies. They have already achieved success and are working closely with IGD. There has been a reduction of 3.7% per case in Tesco's operation worldwide (Tesco plc report, 2009). Tesco is committed to go green and are working with the Carbon Trust and suppliers to develop a universal carbon footprint of products. Tesco plc is striving hard to achieve carbon savings by working with Carbon Disclosure Project, Food and Drink Federation and IGD.

- Financial Performance analysis- Tesco plc and Sainsbury's

On this part we look at the financial analysis of both Sainsbury's and Tesco based on a number of ratios looking at financial stability, profitability and performance. The analysis is over 3 years 2007-2009 and will enable us to compare the financial performance of these 2 very close competitors. This is all derived from the Company's annual report financial information.

- Analysis of Profitability ratios

Profitability ratios demonstrate how a company is using its resources (Atrill, 2002). Profit margins reflect what the company is able to retain in excess to operation costs whereas, return ratios show what revenue company generates for the capital supplier.

Return on capital employed (ROCE)

ROCE reflects the overall return on the capital floating in the business, namely, equity and debt. There is evidence in the business valuation literature that ROCE is affected by market forces and mean reverts in long-term (Palepu, 2004). The mean revert level is towards WACC, which is the long-term weighted-average cost of capital of 8-10%. This shows that the abnormal profits over long periods of the business were eliminated.

Comparing the ROCE of Tesco and Sainsbury's, it is obvious that Sainsbury's is operating below the average at 4-5% over the 3 years analysed, whereas, Tesco measures declined expectedly from 13% in 2007 to 9% in 2009. It is important to note that ratios are affected by the accounting practices usually mentioned in the equity section of the company's balance sheet. It is also vital to understand that ROCE needs to be decomposed to get information of where the performance is coming from ($ROCE = FLEV + RNOA$).

Return on net operation assets (RNOA)

According to Palepu (2007), RNOA levels of old companies revert in long-term to average levels between 8-15% and hence, lower RNOA levels increase and vice versa. Comparison shows that while Sainsbury's RNOA is stable over 3 years, Tesco's RNOA has fallen almost 50%. Tesco has generated returns of 8-5% over 3 years as compared to Sainsbury's. Analysing further, sales for Tesco grew by 10% in 2008 and 13% in 2009 and

the total assets grew 22% and 53% in 2008 and 2009 respectively. The sales growth for Sainsbury's increased from 3% in 2008 to 5% in 2009 and total assets growth was 5% and -1% over the same duration. This 5% increase in sales growth was achieved using the asset base in 2008. RNOA can further be divided to show net operating profit margin (NOPAT) asset turn over.

Profit Margins

Both the companies are performing at relatively higher margins than the industry average of 2.2% (Reuters, 2010). Sainsbury's gross profit margin (GPM) decreased from 6.8% in 2007 to 5.5% in 2009, whereas, Tesco's GPM has been stable at 7.5%. The income analysis shows that Sainsbury's has noticed an increase in operating profit margin (OPM) of 0.6% over 2007-2009 whereas Tesco's OPM has decreased from 6.2% to 5.9%. This shows management involvement in cost control and operational costs at Sainsbury's resulting in increase in OPM. The net operating profit margin for Tesco has decreased over the 3 year period being 4% in 2009. The profit margin of Sainsbury's (after tax) decreased in 2009 with 0.4% to 1.5%. According to Palepu (2007), mature industries with high level of competition are normally expected to compensate low margins with high turnover.

Asset turnover ratio (ATO)

ATO defined as an efficiency measure of the company's assets in generating revenue and has a direct effect on the overall ROCE. Palepu (2007) demonstrated via empirical evidence that ATO tends to stay constant over time except if new technology is introduced and operational efficiency has improved. Both Tesco and Sainsbury's have ATO higher than the industry average of 0.26% (Reuter, 2010) It is rather difficult to analyse the full scope

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of changes in ATO over a 3 year period. Tesco's assets grew from 22% in 2008 to 53% in 2009 but its ATO decreased from 1.72% in 2007 to 1.18% in 2009. However, Sainsbury's ATO increased from 1.78 in 2007 to 1.88 in 2009 demonstrating efficient operational control which balances lower profitability.

- Analysis of Efficiency ratios

A company's operational efficiency is measured by its working capital management and its components. Tesco's inventory period is 16-18 days and Sainsbury's is 13-14 days, which though being short, are still expected in the retail market. Sainsbury's are performing better in receivable collection management with its days receivables being a day below than Tesco's (1.85 days in 2009 for Tesco). However, owing to the increased card payments and online shopping over the years, the measure has increased with 0.5 days for both the companies.

Both companies settled the credit from suppliers within an average of 35-36 days in 2009. However, this has been increasing for Tesco from 32 days in 2007 and decreased from 39 days in 2007 for Sainsbury's. Both have therefore remained competitive in negotiating credit from their suppliers. This shows that Tesco's and Sainsbury's both have healthy short-term financial management.

- Analysis of Liquidity/ Solvency ratios

Solvency and liquidity ratios demonstrate the ability of a company to cover its current liabilities reflecting long-term financial stability. Tesco has a quick ratio above 1 for the whole period and current ratio of around 6 in 2009 as

compared to 3 in 2007. Sainsbury's on the other hand has both ratios below 1 for the same period which are considered to be normal in the food retail industry. However, Sainsbury's ratios in 2009 are lower (0.31) than the industry average (0.82).

Both companies have high debt levels at 50% of equity in terms of solvency, which are double that of industry average 24% (Reuters, 2010).

- Analysis of Share Prices

Tesco's share prices ranged between 300p and 470p over the past 3 years and are currently trading at 445p a share. Sainsbury's is trading at 280-600p per share over the past 3 years and was 330p in 2009. Tesco trades at a slightly better price-to-book ratio (P/B) of 2.60 as compared to P/B of 1.44 for Sainsbury. The industry is highly competitive and this explains the low P/B ratios for both the companies.

Tesco Annual Report 2009

- Chairman's Report

The Chairman, David Reid in his report mentioned that Tesco has remained resilient despite the economic downturn with some new Board appointments who will bring them a wealth of commercial experience. He mentioned that there were 2 significant acquisitions which Tesco made in 2009. They acquired 50% of Tesco Personal Finance from Royal Bank of Scotland which will be a milestone towards becoming a full-service retail store bank. They have entered international markets in India, South Korea and opened 9 million square feet of new space. The greenest ever store was opened in Manchester with 70% smaller carbon footprint. Tesco raised 6.2 billion

pounds and broke their “ Charity of the Year. ” Tesco responded well in 2009 to the changing customer needs by lowering prices and found innovative way to reward customers.

- Chief Executive Officer’s (CEO) Report 2009

Sir Terry Leah, CEO for Tesco described 2009 as a very good year for Tesco in his annual report. Tesco delivered solid sales and profits through the recession. He mentioned that Tesco is committed to change from mass consumption to green consumption and are trying to run the business on 80% less carbon. Tesco Personal Finance came under their ownership and Tesco is expanding every year. 500 new products were launched as part of Tesco’s ‘ Discount Brands.’ Step-Change is the efficiency saving programme which has allowed Tesco to introduce goods at controlled and affordable prices. Innovative electronic check-in milk, bread deliveries eliminated administration costs.

- Corporate Governance Report 2009

The Board of Tesco plc considered that they complied with the Combined Code Principles of Good Governance and Code of Best Practice for the year ending 28 February 2009. The only exception was provision A. 3. 2, according to which half of the Board should consist of non-Executive Directors. The Board completely understands the importance of a balanced Board with certain degree of independence. Two non-executive directors resigned unexpectedly and the Board’s top priority has been to ensure the best and the most suitable candidate with the right skills and experience. The Company appointed 2 Non-executive Directors as replacement for resigned Directors one Non-executive Director to maintain balance once the <https://assignbuster.com/tesco-and-sainsbury-financial-analysis/>

new Group Finance Director is appointed. The Board was thus fully compliant with the standards of Combined Code from 1st April 2009. The Annual Report and Financial Statements 2009 contains the full corporate governance report.

- Auditor's Report 2009

Pricewaterhouse Coopers LLP published the independent audit report for the 53 weeks ended 28 February 2009. This comprises of the Group Income Statement, , Group Statement of Recognised Income and Expense, Group Balance Sheet and Group Cash Flow Statement. The audit report was prepared according to the International Standards on Auditing which is issued by the Auditing Practices Board. The financial statements were prepared under the accounting policies set out therein. In their opinion, the Group financial statements give a fair and accurate which is in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union. The Group financial statements were prepared in accordance with the Companies Act 1985 and Article 4 of the IAS regulation. They also authenticated that the information mentioned in the Report of Directors is consistent with the financial statements of the Group.

- Press releases

According to the press release, “ Tesco is to make an aggressive push into the financial services market, seeking to transform itself into a fully-fledged retail bank.” Tesco plc as a supermarket giant bought the 50% stake for £950m from Royal Bank of Scotland (RBS). It also has got plans to grow its product shares such as its home insurance. In future, Tesco plc is also

planning launching basic bank accounts to compete with the High Street Banks(bbc. co. uk, 2009).

It was described as banking on success as it is actively promoting financial services products like loans, insurance, savings within its stores and is actively selling online.

One press release revealed that Tesco reported annual pre-tax profits of £3.13 billion which was a 10% improvement. Its sales topped £1billion per week with group sales at £59.4 billion. These profits were the highest for a UK food retailer. Press quoted that Terry Leahy said that the retailer would “continue to make good progress even in the current global economic environment.”(bbc. co. uk, 2009)

Conclusion

The financial analysis and ratios for Tesco and Sainsbury’s are derived from the company’s annual report and is a valued tool for investors. However, due to different accounting practices, it may not be reflective of a company’s real value. A company’s future abilities cannot be used to determine its future performance. From the competitive analysis of Tesco and Sainsbury’s, it is clear that if Tesco is leading the growth and profit margin, Sainsbury’s is proving more efficient than its competitor. The annual report also failed to explain Sainsbury’s fast growth at 7.8% towards the latter part of 2009 as compared to 4.3% of Tesco (the Telegraph, June 2009). The current share prices do capture this financial information as the markets reacted very efficiently.