Financial man essay

Business

a) From the financial ratios of the two companies, Tesco performs better compared to Sainsbury.

The Gross profit margin ratio for Tesco for instance is 8. 1% and 7. 7% for the years 2007 and 2006 respectively. For the case of Sainsbury, this is 6. 8% and 6. 7% for 2007 and 2006 respectively.

On the basis of gross profit margin ratio, I could advise the friend to invest in Tesco because Tesco is able to control its cost of goods sold expenses more that Sainsbury. Further, Tesco has a net profit margin ratio of 4. 4% in 2007 compared to a paltry 2% of Sainsbury. In 2006, this ratio was 4% for Tesco and 0. 6% for Sainsbury.

The net profit margin ratio is a measure of how well the company can be able to control both its cost of goods sold as well as operating expenses. Tesco utilizes its equity capital to generate sales better than Sainsbury. This is shown by the higher ROE ratios of 17. 8% and 16. 8% for the years 2007 and 2006 respectively.

Sainsbury does not utilize well the equity at its disposal to generate sales revenue as this ratio is only 7. 4% and 1. 5% for the years 2007 and 2006 respectively. ROCE is a measure of whether the company is an asset generator or a cash consumer. At times it is called Du pont analysis. From Tesco's ROCE, it means that for every sterling pound invested, 0.

112 assets is generated in the year 2007. For Sainsbury, it is only 0. 039. This performance was even better for Tesco in 2006 where 0.

105 of assets were generated for every sterling pound compared to 0. 05 for Sainsbury. The current ratio of Sainsbury is 0. 71 in the year 2007 and 0. 79 in 2006. Tesco had a current ratio of 1. 2 and 1. 08 for the years 2007 and 2006 respectively.

Current ratio measures the company's ability to meet its current obligations as and when they fall due for payment. The acid test ratio indicates a ratio of 0. 496 and 0.

679 for Sainsbury for the years 2007 and 2006 respectively. As for Tesco, this was 0. 73 and 0. 68 for the same respective periods. This ratio indicates the ability of the company to meet its maturing financial obligations from the most liquid assets. b) I would recommend the friend to invest his £ 5000 in Tesco because of the following reasons: 1. Liquidity: Tesco is more liquid compared to Sainsbury. Therefore he is assured of being paid his principal amount incase the company goes under.

Liquidity is measured by the current and acid test ratios. Infact the current ratio of Tesco is increasing whereas that of Sainsbury shows a declining trend. 2. Solvency: – Tesco is more solvent than Sainsbury.

This means that theTesco has little chances of going bankrupt since its low gearing ratios indicate low financial risk. The friend ought to be aware that if the company was to be declared bankrupt, he and other shareholders would not be given the first preference for payment of debts owed by the company. Whenever bankruptcy occurs, the preference shareholders and other debt instrument holders are paid first before shareholders can be paid. He should therefore invest in the more solvent Tesco. 3. Profitability:- Tesco is able to generate higher revenue from the utilization of assets and capital at its disposal.

Investing in Tesco therefore would improve his chances of getting more returns to his original investment of £5000. Most companies pay high dividends when the earnings are high. But for some, it is a constant policy of dividend payment. Assuming that Tesco operates under the retention policy whereby dividends are paid out of what has remained after investment resources have been put aside, then Tesco is likely to pay a constantly growing DPS in perpetuity.

4. Tesco pays higher dividends than Sainsbury as shown by a higher DPS for both 2007 and 2006. No investor can be willing to put his/her money where it doesn't grow. These are the cash returns for investment. The friend, by investing in Tesco would be creating more wealth. And this is in line with the principle goal of a company i. e. to create wealth for its shareholders.

4. Tesco has a higher EPS compared to Sainsbury. This means that Tesco has a higher earnings power. An earnings per share is what the friend would expect to be paid for every share invested. 5. The cover of interest expenses:- The Times interest cover for Sainsbury is low at 3. 55times and 1.

72 times in the years 2007 and 2006 respectively. On the other hand, interest expense is covered 12. 28 and 9. 27 times for Tesco in the years 2007 and 2006 respectively. It is important to invest in a company whereby the finance costs are well covered like Tesco.

This is because such a big cover shows that the finance costs are a small proportion of the operating profits of the firm and do not therefore expose the firm to financial risk problems. AppendixPERFORMANCE RATIOSRATIOS AND FORMULASJ. Sainsbury 2007Sainsbury 2006Tesco2007Tesco20061. ROCE= Net profit after tax Net assets324/8795= 0. 039= 3. 9%58/11782= 0.

005= 0. 5%1881/16655= 0. 112= 11. 2%1586/15045= 0. 105= 10. 5%ROE= Net profit after tax   Equity2007Sainsbury: 324/4349= 0. 074= 7. 4%Year 200658/3965= 0.

015= 1. 5%TescoYear 20071881/10571= 0. 178Year 20061586/9444= 0.

168Gross Profit Margin= Gross profit   SalesSainsbury: Year 20071172/17151= 0. 068= 6. 8%Year 20061067/16061= 0.

067= 6. 7%TescoYear 2007: 3463/42641= 0. 081Year 20063028/39451= 0. 077Net Profit Margin= Net profit after tax   SalesSainsbury, year 2007477/17151= 0.

02= 2%Year 2006104/16061= 0. 006= 0. 6%Tesco Year 20071881/42641= 0. 044Year 20061586/394510. 40 5. GEARING= Fixed Charge Capital Total CapitalSainsbury-20072133/6855= 0. 3Year 20062180/7965= 0. 27Tesco 20074545(4146+399) /15116 (4545+10571)= 0.

3Year 20064036(3742+294)/13480(4036+9444)= 0. 299TIMES INTEREST COVER= Operating Profit   Interest ExpensesSainsbury-2007380/107= 3. 55for2006267/155= 1. 72Tesco-20072653/21612. 28for 2006, 2235/241= 9.

27CURRENT RATIO = Current Assets Current LiabilitiesSainsbury-20071940/2721= 0. 71For 20063845/4810= 0. 799Tesco-20074576/3576= 1. 27For 20063919/3599= 1. 08ACID TEST RATIO= Current Assets-Stock Current LiabilitiesSainsbury-20071350/2721= 0. 496For 20063269/4810= 0.

679Tesco-20074576-1931/3576= 0. 73Tesco-20063919-1464/3599= 0. 68EPS= Earnings attributable to ordinary sharesNo. of ordinary sharesSaisbury-2007235/1687. 5= 19. 2penceFor 200658/1526. 3= 3.

8 penceP/E RATIO = MPS EPSSainsbury-2007525. 5/19. 2= 27. 4DIVIDEND YIELD RATIO= DPS MPS9.

75/525. 9= 1. 8%DIVIDEND COVER RATIO= EPS DPS324/88= 3. 2 times58/17. 4= 3. 3 timesREFERENCESL.

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