Report on financial analysis

Business, Company

About the Report:

The report is based on financial and fundamental analysis of four leading supermarket companies, i. e. Wal-Mart, Sainsbury, TESCO Plc and Kroger. Important to note, that, the conclusion at the end will be based on the individual analysis of each company and not by comparing them.

Wal-Mart:

Wal-Mart is the most renowned supermarket chain in the world and is also the world’s largest corporation providing employment to over two million employees. Founded in the year 1962, the company is still run as a family business with Walton family holding over 50% share in Wal-Mart through their holding company, Walton Enterprises. The company is also one of the world's most valuable companies.

Kroger:

Founded in the year 1883, Kroger Company is an American retailer headquartered in Ohio. In terms of revenue, the company is the country’s second largest supermarket chain after Wal-mart. As of February, 2013, the company was operating 24234 stores in USA either through direct holding or through subsidiaries.

TESCO PLC:

TESCO PLC is the leading multinational supermarket china in the United Kingdom. The company, after Wal-Mart is the second largest supermarket chain in the world, measured in terms of revenue and profits. Headquartered in Hertfordshire, England, the company operates in 12 countries across UK, North America, Asia and Europe. The company holds maximum market share of 30% in the United Kingdom, followed by Sainsbury's which owns market share of 17%.

Sainsbury:

Founded in the year 1869, the company was formed by James Sainsbury; Sainsbury's is the second largest supermarket chain in the United Kingdom after TESCO Plc. By the end of 2013, the company had a total market share of 17. 7% and had three divisions namely:

- Sainsbury's Supermarkets Ltd
- Sainsbury's Convenience Stores Ltd (Sainsbury's Local)
- Sainsbury's Bank.

Ratio Analysis

With the objective of unearthing the financial position of each of the companies, we shall now conduct the ratio analysis of each company:

i)Current Ratio: Current Assets/ Current liabilities

Also known as Pure Balance Ratio, this ratio indicates the ability of an entity to honor its short term obligations. In other words, it indicates the working capital position of an entity

Analysis:

Referring to the above data and graph we can figure out that except for TESCO, the liquidity ratio of all the other companies is in declining trend. As for Wal-Mart, the current ratio of the company has been declining since 2011 and stood at 0. 83 till 2013. On the other hand, Kroger, which was enjoying a stable and sustainable liquidity until 2011, saw a significant decline in the current ratio during 2012 and 2013. During these years, the current ratio of the company stood at 0. 80 and 0. 72, respectively.

As of UK Supermarket companies, Sainsbury has indicated an upside-downside trend in their ratios, although TESCO after its consistent decline in the current ratio since 2009, had finally managed a marginal increase in its current ratio from 0. 68 to 0. 69.

ii)Average Collection Period: 365/ Debtor Turnover Ratio

This ratio indicates the number of days it takes for the customers of the company to pay their bills. Average collection period is the direct indicator of the credit policy of the company.

Referring to the above calculated ratios and graph, we can interpret that the average collection period has increased for each company. As for Wal-Mart, the ratio has increased consistently over the years and the same trend in witnessed in the collection period of Kroger and Sainsbury. However, important to note that while the collection period of these companies increased marginally, TESCO on the other hand, saw a significant rise in its collection period. For Instance, during 2009 the debt collection period of the company was only 3. 03 which increased to 10. 04 days in 2013.

iii) Total Asset Turnover: Revenue/ Average Total Assets

The effectiveness of the firm’s use of its total assets to create revenue is measured by total asset turnover.

Analysis:

Referring to the above calculated ratios and graph, we can interpret that while the asset turnover ratio of Wal-Mart, TESCO and Sainsbury remained under the sustainable range with upside and downside trends, Kroger on the other hand, managed to increase its asset turnover ratio consistently over the years. During 2013, the ratio increased significantly from 3. 85 to 4. 02, indicating the efficiency of the management to use its asset base to generate revenue for the company.

iv) Return on Sales: Net Income/ Revenue

This ratio indicates the bottom line profits being earned by the company after deducting all the operating as well as non-operating expenses from its gross earnings. Return on sales carries great significance for the investors and analyst as it indicates the profit margins earned by the company which surely affect the investment decisions of the shareholders and ratings by the analyst.

v) Return on Assets: Net Income/ Total Assets

Another set of profitability ratio that indicates the returns earned by the company on its asset base.

Analysis:

Beginning our analysis with Wal-mart, the company managed to increase its ROA till 2011 and after a significant decline in 2012 when the ratio declined from 9. 33% to 8. 39%, managed to increase the ratio multiple to 8. 57% in 2013. On the other hand, the trend in ROA of Kroger is highly dynamic as after a significant decline from 5. 49 to 0. 30% in 2010, the company managed to increase the ratio to 4. 79% in 2011. However, a year later the ratio again declined to 2. 56% which again increased to 6. 22% in 2013.

As for the UK supermarket companies, a significant decline was witnessed in TESCO’s ROA multiple during 2013 when the ratio declined from 5. 73% to 0. 25%. A similar trend was witnesses for Sainsbury, when the after a significant increase in the ROA multiple from 2. 87% to 5. 6% in 2010, the ratio declined consistently and stood at 4. 91% in 2013.

vi) Return on Equity: Net Income/ Total Shareholder Equity

ROE multiple indicates the level of profit margins earned by the company for the shareholders. This ratio carries great importance as high ROE can attract additional investment from the shareholders and a low ROE multiple can force the shareholders to withdraw their investment in the company:

Analysis:

Referring to the above calculated ratios and graph, we can observe that of all the companies, Kroger had the highest improvement in its ROE multiple which stood at 36. 57% in 2013. On the other hand, TESCO PLC, recorded the lowest ROE with 0. 72% return in 2013. On the other hand, Wal-Mart managed a marginal improvement in ROE multiple from 22. 5% to 23. 02% in 2013.

vii) Time Interest Earned: Operating Earnings/ Interest Expense

Also known as Interest Coverage Ratio, this solvency ratio indicates if the company will be able to honor its interest obligation:

Dividend Growth Rate

ii) CAPM Model:

CAPM Model is one of the most widely used valuation model for ascertaining the cost of equity of the company. Below is the formula for calculating cost of equity using CAPM Model:

Cost of Equity: Risk free rate+ Beta(EMarket- Risk Free Rate)

- Risk Free Rate: 10 year treasury bond yield: 2. 58%

- EMarket= 5 Year annualized average S&P 500 return: 17. 94%

- Beta: Respective beta of each stock is obtained from financial website

i) Wal-Mart= 2. 58+ 0. 37(17. 94-2. 58)

= 8. 26%

ii) Kroger= 2. 58+ 0. 99(17. 94-2. 58)

= 17. 78%

iii) TESCO Plc= 2. 58+ 0. 68(17. 94-2. 58)

= 13. 04%

iv) Sainsbury= 2. 58+ 0. 65(17. 94-2. 58)

= 12. 56%

PE Model

Price Earning Model, popularly known as PE Model is one of the most widely used equity valuation model, where the analyst using the Price of the Stock and EPS of the company calculates the intrinsic value of the stock using the following formula:

Intrinsic Stock Value: PE Ratio* EPS

Calculated below is the intrinsic value of the stocks on the basis of current data:

i) Wal-Mart:

PE: 15. 34

EPS: 4. 88

Intrinsic Value: 15. 34*4. 88= $74. 85

ii) Kroger:

PE: 16. 96

EPS: 2. 90

Intrinsic Value: 16. 96*2. 90= $49. 184

iii) TESCO Plc:

PE: 24. 21

EPS: 23. 75

Intrinsic Value: 24. 21* 23. 75= € 574. 98

iv) Sainsbury:

PE: 9. 6

EPS: 32. 80

Intrinsic Value: 32. 80* 9. 6= £314. 88

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