

Financial statement
analysis tesco
sainsburys
economics essay



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The food and drink retail sector is the largest industry in the United Kingdom, given employment for more than three million people. UK retail sales are around £330bn, the 3rd largest in the world, after the USA and Japan. The retail sector generates 8% of the GDP of the UK, and 5.3% of GVA. “ There are 450, 000 shops in the UK owned by 300, 000 enterprises, including 9% (190, 000) of all VAT-registered businesses. Following strong growth in recent years, internet sales currently account for only around 9% of total sales. Definitively, UK retail is one of the world’s most competitive and innovative industries”. (Department for business innovation & Skills, 2012)

The report below provides an insight into the supermarkets companies, Tesco and Sainsbury’s, with emphasis on its external environment analysis and company’s analysis of resources, competence and culture.

Fig 1: Share of Leading Players in UK Food Retail Market

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PESTEL Analysis

The PESTEL framework below analyses the dynamic and unpredictable environment in which Tesco and Sainsbury’s operates by identifying the forces that have the most impact on their performance:

Political

The introduction of China to the WTO has encouraged the free flow of foreign trade through the adoption of all barriers promoting Western companies, including Tesco, to make way for more profitable market in the world covering more than 1.3 billion people (Straits Times, 2010). In 2009 a

contract was signed by Tesco to establish a number of companies for the spread of commercial centres in China.

Sainsbury can get into the markets of emerging corporations by joint ventures or partnerships to explore these new markets, in spite of it have no strategies on the future to do. (Rigby, 2008)

Economic

Economic factors should always be measured for Tesco and Sainsbury, as they reflect directly on the buying conduct of clients. Though the UK economy into recession formally confirmed in 2008, the government reduced interest rates facilitated to minimize new increases in unemployment in 2009 (Euromonitor, 2010). Due to this, the purchasing power of clients is back on a steady increase, as they are more secure in their current financial condition. (Keynote, 2010).

On the other hand, the positive side of the recession is that clients have reduced amount of times that eat out so the customers eat more at home that offers opportunities for food retailers such as Tesco and Sainsbury increase production (Guardian, 2010). It should be noted that the groceries is the last thing customers decrease. The percentage of total expenditure on groceries has increased considerably in recent years, as shown below (Euromonitor, 2010):

Fig 2: UK Spending on Food as % of Overall Consumer Spending 2004 to 2008

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Social

A study of the UK population demonstrates that there are more retirees than boys (Herald Scotland, 2010). The aging inhabitants is negative for groceries retailers and that older people tend to eat less and are less probable to go to the shop to buy compared to younger people. Though the level of internet literacy falls over the age of 65 years in the inhabitants (Turban et al., 2001), yet it has been estimated that the aging of the population is online shopping more suitable.

Technological

The performance of supermarkets is affected by the use of the Internet through retail food online, which is presentation a stable increase. The Internet subscriptions have increased by over 50% and it is expected that the Internet is being used by 70% of the inhabitants in the UK (Office for National Statistics, 2010).

Loyalty programs are also being established through information technology that discourage clients from changing to competitors (Sun, 2009).

Environmental

Because consumer consciousness about the carbon dioxide of the company (Wood, 2009), Tesco and Sainsbury have added information about carbon dioxide in dairy products, potatoes and orange juice, and the objective is

expanding to the elements bread and products that is not food in 2010 (Tesco, 2010, Sainsbury 2010).

Tesco has submitted the Greener Life Plan to give clients recommendation on environmental topics, including how to decrease food waste and carbon dioxide in the preparation of meals (Yuthas, 2009).

Tesco is also rewarding customers with points in the GreenClub card for reusing the bags, recycling mobile phones and aluminium can. (Tesco, 2009; Datamonitor, 2010).

Legal

The last increase of the VAT (20%) has affect to the non-food sectors of Tesco, such as clothing.(GOV. UK, 2012)

Due to the reform of the low pay commission report (National Minimum Wage, 2009), the minimum wage has increased by a 15. 5% so Tesco's and Sainsbury's operation costs have increased.

Altman's Z scores

The Altman Z-Score is a simple method that analysed the company's financial strength. What tell us this method is the chances of failure established by a combination of financial ratios. The model was created in 1960 by Edward Altman, a professor at New York University. (Rankia, 2007)

Z-score above 3: The company has no chance of bankruptcy and is considered safe.

Z-score between 2.7 and 2.9: It's in precautionary area. It should be a very detailed analysis before entering the company.

Z-score between 1.8 and 2.7: Alert zone. If financial conditions do not change quickly, it is very probable that the company go into bankruptcy in the next two years.

Z-score less than 1.8: Bankruptcy is imminent. The financial risk is at the maximum level.

TESCO

X1= Working capital/Total Assets

$$2009: X1 = \frac{13479 - 17595}{45564} = -0.090$$

$$2010: X1 = \frac{11765 - 16015}{46053} = -0.092$$

$$2011: X1 = \frac{11438 - 17731}{47206} = -0.133$$

X2= Retained Earnings/Total Assets

$$2009: X2 = \frac{2166}{45564} = 0.047$$

$$2010: X2 = \frac{2336}{46053} = 0.050$$

$$2011: X2 = \frac{2671}{47206} = 0.056$$

X3= EBIT/Total Assets

$$2009: X3 = \frac{3169}{45564} = 0.069$$

$$2010: X3 = \frac{3457}{46053} = 0.075$$

$$2011: X3 = \frac{3811}{47206} = 0.081$$

X4= Market value of equality/Total Liabilities

$$2009: X4 = 7895.3M / 3.582 / 32658 = 0.87$$

$$2010: X4 = 7985M / 4.255 / 31342 = 1.084$$

$$2011: X4 = 8046.5M / 30583 = 1.05$$

X5= Sales/Total Assets

$$2009: X5 = 53898 / 45564 = 1.18$$

$$2010: X5 = 56910 / 46053 = 1.23$$

$$2011: X5 = 60931 / 47206 = 1.29$$

Z score: 1.2 * X1 + 1.4 * X2 + 3.3 * X3 + 0.6 * X4 + 1.0 * X5

$$2009: 1.2 * -0.090 + 1.4 * 0.047 + 3.3 * 0.069 + 0.6 * 0.87 + 1.0 * 1.18 = 1.89$$

$$2010: 1.2 * -0.092 + 1.4 * 0.050 + 3.3 * 0.075 + 0.6 * 1.084 + 1.0 * 1.23 = 2.1$$

$$2011: 1.2 * -0.133 + 1.4 * 0.056 + 3.3 * 0.081 + 0.6 * 1.05 + 1.0 * 1.29 = 2.1$$

Tesco has improved slightly the financial situation as it is shown in the Z score result. It has increased from 1.89 in 2009 to 2.1 in 2011. 2.1 is a better situation for the company but it still need to improve because with a result of 2.1 in the Z score Tesco is in a risky situation. Tesco should increase this number until get at least about 2.8.

Sainsbury's

X1= Working capital/Total Assets

$$2009: X1 = 1591 - 2919 / 10033 = -0.132$$

$$2010: X1 = 1852 - 2793 / 10855 = -0.087$$

$$2011: X1 = 1721 - 2942 / 11399 = -0.107$$

X2= Retained Earnings/Total Assets

$$2009: X2 = 289 / 10033 = 0.029$$

$$2010: X2 = 585 / 10855 = 0.054$$

$$2011: X2 = 640 / 11399 = 0.079$$

X3= EBIT/Total Assets

$$2009: X3 = 673 / 10033 = 0.067$$

$$2010: X3 = 710 / 10855 = 0.065$$

$$2011: X3 = 851 / 11399 = 0.075$$

X4= Market value of equality/Total Liabilities

$$2009: X4 = 1738.5M * 3.13 / 5657 = 1.01$$

$$2010: X4 = 1821.7M * 3.031 / 5889 = 1.02$$

$$2011: X4 = 1921M * 3.51 / 5975 = 1.13$$

X5= Sales/Total Assets

$$2009: X5 = 18911 / 10033 = 1.88$$

$$2010: X5 = 19964/10855 = 1.84$$

$$2011: X5 = 21102/11399 = 1.85$$

$$\mathbf{Z \text{ score: } 1.2 * X1 + 1.4 * X2 + 3.3 * X3 + 0.6 * X4 + 1.0 * X5}$$

$$2009: 1.2 * -0.132 + 1.4 * 0.029 + 3.3 * 0.067 + 0.6 * 1.01 + 1.0 * 1.88 = 2.59$$

$$2010: 1.2 * -0.087 + 1.4 * 0.054 + 3.3 * 0.065 + 0.6 * 1.02 + 1.0 * 1.84 = 2.637$$

$$2011: 1.2 * -0.107 + 1.4 * 0.079 + 3.3 * 0.075 + 0.6 * 1.13 + 1.0 * 1.85 = 2.725$$

Sainsbury's has been in a risky situation over the past 3 years although has improved the financial situation year by year. If Sainsbury's continues increasing this result it will be in the precautionary area by 2013.

Z score Tesco – Sainsbury's

Tesco Sainsbury's

2009 1.89 2.59

2010 2.1 2.637

2011 2.1 2.725

As it is shown in the table, Sainsbury's has a better financial situation and also did a better improvement over the years but it is needed to consider the differences between these companies. Tesco and Sainsbury's are companies of different sizes and there are big differences in their figures so it is not a fair comparison but it can be useful as a guide of how is the situation of each company.

FTSE graphs

According to Mark Kolakowski (2012), “ There are several Financial Times Stock Exchange, or FTSE, indexes. The most commonly-quoted is the FTSE 100, originally developed by the Financial Times newspaper and which includes the 100 largest companies by market value on the London Stock Exchange.”

In the following graph it is shown the evolution of Sainsbury’s and Tesco’s shares of the last three years and also it is compared with the FTSE 100 index.

Performance comparison: 10/12/2009 – 09/12/2012

Percentage change

First

Last

High

Low

J Sainsbury plc

+7.69 %

318.60

343.10

395.00

263.50

FTSE 100

+12.78 %

5,244.37

5,914.40

6,091.33

4,805.75

Tesco

-19.63 %

419.00

336.75

454.40

297.05

(Sainsbury's, 2012)

Share Evaluation tool

<http://www.quizzing.in/wp-content/uploads/2011/07/TESCO.jpg>

<http://www.mystudentsite.co.uk/users/andrewhawes1112/Sainsburys/sainsburyslogo2.png>

Earnings per share:

Net profit for the year / number of ordinary shares in issue $\times 100$

$$2009: 2138000000/7895344018 \times 100 = 27$$

$$2010: 2336000000/7985044057 \times 100 = 29$$

$$2011: 2671000000/8046468092 \times 100 = 33$$

Earnings per share:

Net profit for the year / number of ordinary shares in issue $\times 100$

$$2009: 289000000/1738500000 \times 100 = 16.6$$

$$2010: 585000000/1821700000 \times 100 = 32$$

$$2011: 640000000/1921000000 \times 100 = 33$$

Price/Earnings ratio:

Market price per share / EPS

$$2009: 3.582/0.27 = 13.27 \text{ years}$$

$$2010: 4.2955/0.29 = 14.67 \text{ years}$$

$$2011: 3.981/0.33 = 12.06 \text{ years}$$

Price/Earnings ratio:

Market price per share / EPS

2009: $3.13 / 0.166 = 18.85$ years

2010: $3.331 / 0.32 = 10.41$ years

2011: $3.51 / 0.33 = 10.64$ years

Gearing Ratio:

Long term liabilities / Share capital + reserves + long term loans x100

2009: $12391 / (12906 + 12391) \times 100 = 48.98\%$

2010: $11744 / (14681 + 11744) \times 100 = 44.44\%$

2011: $9689 / (16623 + 9689) \times 100 = 36.82\%$

Gearing Ratio:

Long term liabilities / Share capital + reserves + long term loans x100

2009: $2738 / (4376 + 2177) \times 100 = 41.78\%$

2010: $3096 / (4966 + 2357) \times 100 = 42.27\%$

2011: $3033 / (5424 + 2339) \times 100 = 39.07\%$

Interest Cover:

NPBIT / Interest payable

2009: $3169 / 562 = 5.64$ Times

2010: $3457 / 690 = 5.01$ Times

2011: $3811 / 614 = 6.2$ Times

Interest Cover:

NPBIT / Interest payable

2009: $673/128 = 5.25$ Times

2010: $710/111 = 6.4$ Times

2011: $851/126 = 6.75$ Times

(Assessment 1, 2012)

The investment ratios show that both are good companies to invest on. From 2009 to 2011 Sainsbury's has improved more than Tesco although in the last analysed year (2011) the shareholders will earn the same amount of money per share in both companies.

Another point to consider is the number of shareholders of each company because it will affect the earning per share. By the way Sainsbury's has less shareholders and considering the fact that in 2011 the earning per share was the same as Tesco's, it might be better to invest in Sainsbury's.

(Assessment 1, 2012)

The economic downturn has been brought to light with the assistance of the following GDP growth graph since 1989 (Intel, 2009):

Fig 3: UK GDP Growth 1989-2009

Fig 3: UK GDP Growth 1989-2009

united-kingdom-gdp-growth. png

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After three consecutive periods of falling gross domestic product (GDP), the UK's economy grew by 1 per cent during the third quarter of 2012.

The services sector accounted for the whole of the economy's growth in this period. A 0.2 percentage point contribution to quarterly GDP growth from higher production sector output – the first positive contribution in the sector since the third quarter of 2010 – was offset by a negative contribution of 0.2 points from construction.

Growth of 1.0 per cent in the third quarter is the strongest since the third quarter of 2007. The strength in the quarter however can partly be attributed to the loss of a working day associated with the Diamond Jubilee bank holiday which subdued output in the second quarter, resulting in growth being calculated from a lower base. In addition, hosting the London 2012 Olympics and Paralympics may also have had an impact on growth, especially as ticket sales were accrued to the quarter when they were used rather than the period when they were purchased. It is estimated that ticket sales added 0.2 percentage points to GDP growth in the third quarter.

Real GDP in the third quarter of 2012 was unchanged from its level a year earlier, even with the benefit of the Olympic and Paralympics ticket sales. (UK Statistics, 2012)

Conclusion

Once realized the above analysis, it possible to conclude that continues to lead Tesco and Sainsbury continues to improve its situation in the highly volatile retail segment, where companies are forced to pursue cost

leadership and differentiation strategies. Tesco has been able to achieve this
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with the help of a system of supply chain management simple and fast and the strategic use of information technology. Meanwhile, Sainsbury's is strongly focused on food, and this is the prime reason why customers visit its stores.

The core competencies of Tesco have been integrated with the business environment; so, it augurs a positive future for the company.