Financial analysis of Tesco and Sainsbury

Name

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Introduction

Sainsbury PLC is a UK company involved in retailing grocery related products and banking activities (Uk.finance.yahoo.com, 2015). It conducts its operations through its three segments; Financial Services, Property Investments, and Retailing segments. As of 14th of March 2015, the company had 1,304 supermarkets and convenience stores. It also provides insurance, energy efficiency advice, credit cards, entertainment products, among other services. Tesco is a company that deals in the design and assembly of technology-based solutions. It has two segments; Tubular Services and Top Drive Segments (Finance.yahoo.com, 2015). The Top Drive Segment manufactures top drive services and electronically powered equipment. The Tubular Services Segment provides tubing running services, casing, and automated offerings for oil as well as natural gas companies. This paper uses a range of financial ratios to analyze the financial performance of the two companies for the three-year period ending January/February 2015.

PROFITABILITY ANALYSIS

Gross profit margin

Gross profit margin indicates the gross profit a company earns per pound of total net sales (Stickney and Stickney, 2010). In the year ending 28th February 2015, Tesco PLC had a gross profit margin of -3.39% indicating that it made a gross loss of £0.0339 for every pound of net revenue. This implies that the company's operations were not profitable in 2015. It also shows that it did not generate adequate earnings to cover for additional expenses. The gross profit margin was 6.31% in 2014 and 6.55% in 2013. The trend shows that the profitability of Tesco PLC declined throughout the period from 2013 to 2015.

Sainsbury's gross profit margin for the year 2015 was 5.081% implying that it earned a gross profit of £0.05081 per pound of net sales. The ratio was positive meaning that the company had about 5% of the total revenue for paying both operating and non-operating costs such as interest expense. The ratio was 5.480% in 2013 and 5.791% in 2014. The trend shows that the profitability of Sainsbury improved in 2014 before declining in 2015. The gross profit margin for Sainsbury was more than that of Tesco in 2015. This suggests that Sainsbury was more profitable than Tesco.

Operating profit margin

It shows that percentage of the total revenue that is left after paying the operating expenses (Stickney and Stickney, 2010). Tesco's operating profit margin for 2015 was -9.30% implying that it made an operating loss of £0.093 per pound of total sales. Therefore, Tesco's operating activities were not profitable in the year 2015. The ratio was 4.14% and 3.76% in 2014 and 2013 respectively.

On the other hand, Sainsbury had an operating margin of 0.3407% in 2015 indicating that 0.34% of its total revenue was left after meeting all the operating costs. The operating margin for Tesco increased from 3.806% in 2013 to 4.213% in 2014 then fell to 0.3407% in 2015. The trend suggests a decrease in the profitability in 2015. Sainsbury's operating margin was more than that of Tesco for each of the three years implying that it was more profitable than Tesco.

Net profit margin

In the year ended 28th February 2015, Tesco had a net profit margin of -9.26% implying that it made a net loss of £0.096 for every pound of net revenue it generated during the year. The negative net profit margin shows that Tesco was not profitable in 2015. The company's net profit margin increased from 0.038% in 2013 to 1.53% in 2014. The trend shows that the profitability of Tesco increased in 2014 but declined in 2015.

Sainsbury's net profit margin for 2015 was -0.6982% meaning that it made a net loss of £0.006882 for every pound of total revenue generated during the year. This was a decline from the 2.99% net profit margin in 2014. This indicates that the profitability of the corporation fell in 2015. In 2013, the net profit margin was 2.6335%. Therefore, the profitability of Sainsbury declined throughout the period from 2013 to 2015. The net profit margin for Sainsbury was more than that of Tesco for all the three years under consideration. This implies that Sainsbury was more profitable than Tesco.

LIQUIDITY ANALYSIS

Current ratio

The current ratio indicates the amount of current assets available per pound of current obligations (Libby, Libby and Short, 2011). A current ratio of more than one implies that a business has sufficient current assets to pay its short-term obligations (Libby, Libby and Short, 2011). As at 28th February 2015, the current ratio for Tesco was 0.6038 implying that its current assets were not adequate to pay all its current liabilities. The current assets could only meet 60.38% of the total current obligations. The firm's current ratio increased from 0.7002 in 2013 to 0.7709 in 2014 then declined to 0.6038 in 2015. This suggests that the liquidity of Tesco increased in 2014 but fell in 2015.

Sainsbury's current ratio was 0.6507 showing that its current assets were 65.07% of the total current liabilities. Therefore, Sainsbury's current assets were insufficient to repay all its current obligations. The ratio was 0.6458 in 2014 and 0.6144 in 2013. The above trend indicates that the liquidity of Sainsbury improved in all the three years under consideration. Sainsbury had a better liquidity than Tesco in 2015. However, in 2014 and 2013, Tesco's liquidity was higher than that of Sainsbury.

Acid test ratio

The quick ratio for Tesco was 0.4545 in 2015 thus its quick assets could meet only 45.45% of its total current obligations (Libby, Libby and Short, 2011). The quick ratio was less than the desired/rule of thumb's value of 1. The ratio was 0.5937 in 2014 and 0.5002 in 2013. This shows that the liquidity of Tesco improved in 2014 but declined in 2015.

The quick ratio for Sainsbury was 0.5067 in 2015 indicating that its quick assets were 50.67% of the total value of its current obligations. Therefore, the quick assets were not adequate to cover all its short-term obligations. The ratio increased from 0.2976 in 2013 to 0.4973 in 2014. This indicates that Sainsbury's liquidity improved in both 2014 and 2015. Sainsbury had a better liquidity than that of Tesco in 2015. In 2013 and 2014, Tesco's liquidity was higher than that of Sainsbury.

EFFICIENCY ANALYSIS

Asset Turnover

Asset turnover shows the amount of net revenue a company generates per pound of average total assets used in a year (Gibson, 2010). Tesco's asset turnover for 2015 was 1.320 meaning that it made net revenue of £1.320 for each pound of the total assets used in 2015. It was, therefore, efficient since it generated more revenues than the amount of assets used during the year. The ratio increased from 1.257 in 2013 to 1.267 in 2014. The trend shows that the efficiency of Tesco improved throughout the three years.

Sainsbury's asset turnover was 1.438 in the year 205 implying that it made net revenue of £1.438 for every pound of the average total assets used in 2015. This indicates that Sainsbury is efficient in using its assets to make revenue. The ratio was 1.638 in 2014 and 1.862 in 2013. The trend shows that Sainsbury's efficiency in generating revenue from the use of its assets declined throughout the three years. During all of the three years, the asset turnover for Sainsbury was more than that of Tesco. This means that Sainsbury was more efficient in generating revenues from the use of its assets than Tesco.

Receivables collection period

The ratio shows the time a business from the date of making a credit sale to collect money from its debtors (Gibson, 2010). The ratio indicates how efficient a company's credit management policies are. It has a significant impact on cash availability and liquidity of the firm. The average collection period for Tesco in the year ended February 2015 was 12.63 days indicating that Tesco took an average of 13 days to collect money from its receivables. The collection period decreased from 14.92 days in 2013 to 13.54 days in 2014. The decline in the collection period indicates that the efficiency of Tesco's debt collection increased in 2014 and 2015.

The average collection period for Sainsbury in the year ended February 2015 was 6.94 days showing that it took an average of 7 days to collect money from its debtors. The collection period was 4.64 days in 2013 then increased to 5.63 days in 2014. The rise in the Sainsbury's average collection period indicates that its efficiency in debt collection declined in both 2014 and 2015. The ratios indicate that Sainsbury was more efficient in receivables collection than Tesco. However, the trend shows that Tesco's debt collection efficiency is improving while that of Sainsbury is declining.

Payables payment period

The ratio gives the average time a business takes to settle its creditors. The measure is important as it affects the liquidity of the company (Gibson, 2010). A very short payables payment period reduces the liquidity of the company while a very long payment period reduces the company's chances of access to credit facilities. Tesco's payables payment period was 58.15 days in 2015. The ratio declined from 68.77 days in 2013 to 66.47 days in 2014. The decline indicates an improvement in the company's payment of its creditors. The company's payables payment period is longer than its receivables collection period hence the payment of creditors does not adversely affect its liquidity.

Sainsbury's payables payment period for the year ended February 2015 was 45.72 days. This was favourable since it was longer than the firm's receivables collection period. The ratio increased in 2015 from 43.83 days in 2014. The year 2014 saw a decline in Sainsbury's payables payment period from 45.29 days in 2013. The values indicate that Sainsbury takes a shorter time to settle its creditors than Tesco.

Inventory turnover period

Inventory turnover period shows the average duration a company takes to sell its stock. A large amount of inventory reduces the quick ratio thus limiting the liquidity of the firm (Barrow and Barrow, 2008). Therefore, a shorter inventory turnover period is desirable. Tesco's inventory holding period in the year ended February 2015 was 18.51 days. The ratio declined from 22.43 days in 2014. The year 2014 also saw the company's inventory turnover period fall from 22.61 days in 2013. The decrease in inventory turnover period indicates that the Tesco's efficiency in converting its stock into revenues increased in both 2014 and 2015.

Sainsbury’s inventory turnover period was 16.19 days in the year ended February 2015. The ratio had increased from 16.11 days in 2014. In 2013, Sainsbury’s inventory turnover period was 15.95. The rise in the ratio implies a decline in Sainsbury’s efficiency in selling its stock to generate revenues. The inventory turnover period for Sainsbury was less than that of Tesco in each of the three years under consideration. This shows that Sainsbury is more efficient in selling its stock than Tesco.

SOLVENCY ANLSYSIS

Interest cover

The ratio shows the adequacy of earnings before interest and tax to cover the company’s interest obligations. In the year ended February 2015, Tesco’s interest cover was -8.646 times indicating that its earnings before interest and taxes were not sufficient to meet its interest obligations. In the year 2014, Tesco’s interest cover was 5.005 times implying that its earnings before interest and taxes were enough to cover its interest expense. The ratio had increased from 4.979 times in 2013 showing an increase in the solvency of Tesco in 2014. However, the decline in the company’s interest cover in 2015 indicates a fall in its solvency.

Sainsbury’s interest cover was 0.6 times in the year ended February 2015. This shows that its earnings before interest and tax could only cover 60% of the total interest expense. The interest cover declined from 6.648 times in 2014 hence the solvency of Sainsbury fell in 2015. In 2013, the interest cover was 6.549 times. The increase in the interest cover in 2014 suggests that the solvency of Sainsbury improved in 2014. In each of the three years, the interest cover for Sainsbury was more than that of Tesco implying that Sainsbury was more solvent than Tesco.

Financial gearing

Financial gearing indicates that proportion of fixed interest obligations in the capital structure of the company. The financial gearing for Tesco was 0.6010 indicating that fixed interest debt was about 60% of its total capitalization. This shows that its solvency is low since the debt was more than 50% of the total capitalization. Tesco's financial gearing increased from 0.3766 in 2013 to 0.3872 in 2014 showing a decline in its solvency in both 2014 and 2015.

Sainsbury's financial gearing was 0.3115 in 2015 implying that its total borrowing was 31.15% of the total capitalization. The ratio is less than 50% hence the company was solvent. The financial gearing increased from 0.2723 in 2014 showing a decline in the solvency of Sainsbury. The ratio had dropped in 2014 from 0.3134 in 2013. This indicates that the solvency of Sainsbury improved in 2014. The financial gearing for Sainsbury was less than that of Tesco throughout the three years.

Capital gearing

Capital gearing shows the amount of common equity for every pound of fixed interest bearing funds. Tesco's capital gearing was 0.6639 implying the common shareholders' equity was less than debt. The ratio declined from 1.583 and 1.655 in 2014 and 2013 respectively. The decline shows a decline in Tesco's solvency. Sainsbury's capital gearing was 2.210 in 2010 down from 2.668 in 2014. The ratio had increased in 2014 from 2.191 in 2013. Sainsbury had a higher solvency than Tesco.

Weaknesses of financial ratio analysis

Differences in the nature of operations make comparison using ratios misleading. For instance, a retailing store would require a large stock hence the quick ratio may be lower than that of financial services company (Gibson, 2010). Besides, the analysis is limited by differences in accounting policies. It is difficult whether a ratio is good or not. For example, we cannot ascertain whether Tesco's receivables collection period of 12.63 days is bad or good.

Conclusion

The analysis indicates that Sainsbury was more profitable than Tesco since it had a higher net profit margin. The liquidity of Tesco was better than that of Sainsbury in 2013 and 2014. The liquidity of Sainsbury improved during the period and was better than Tesco's in 2015. Efficiency ratios show that Sainsbury was more efficient than Tesco in debt collection, use of assets to generate revenue and selling inventory. Sainsbury also took a relatively shorter duration to settle its accounts payable. Tesco can review its debt management policy to increase debt collection efficiency. Some of the measures include offering discounts, offering credit to creditworthy clients, among other ways. The gearing ratios also indicate that Sainsbury is more solvent than Tesco. The financial risk is more in Tesco than in Sainsbury. Tesco should review its capital structure by issuing additional equity. Furthermore, measures to increase profitability will improve interest cover thus reducing the financial risk.

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APPENDICES

TESCO PLC

Ratio	Formula	Year ending 28th Feb 2015	Year ending 22nd Feb 2014	Year ending 23rd Feb 2013
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	$\frac{11,958}{19,805}$ **= 0.6038**	$\frac{15,572}{20,206}$ **= 0.7709**	$\frac{13,096}{18,703}$ **= 0.7002**
Acid test ratio	$\frac{\text{Current assets} - \text{inventories}}{\text{Current liabilities}}$	$\frac{11,958 - 2,957}{19,805}$ **= 0.4545**	$\frac{15,572 - 3,576}{20,206}$ **= 0.5937**	$\frac{13,096 - 3,744}{18,703}$ **= 0.5002**
Gross profit margin	$\frac{\text{Gross profit}}{\text{Total sales}} \times 100\%$	$\frac{-2,112}{62,284} \times 100\%$ **= -3.39%**	$\frac{4,010}{63,557} \times 100\%$ **= 6.31%**	$\frac{4,154}{63,406} \times 100\%$ **= 6.55%**
Operating profit margin	$\frac{\text{Operating profit}}{\text{Total sales}} \times 100\%$	$\frac{-5,792}{62,284} \times 100\%$ **= -9.30%**	$\frac{2,631}{63,557} \times 100\%$ **= 4.14%**	$\frac{2,382}{63,406} \times 100\%$ **= 3.76%**
Net profit margin	$\frac{\text{Net profit}}{\text{Total sales}} \times 100\%$	$\frac{-5,766}{62,284} \times 100\%$ **= -9.26%**	$\frac{970}{63,557} \times 100\%$ **= 1.53%**	$\frac{24}{63,406} \times 100\%$ **= 0.038%**
Asset turnover	$\frac{\text{Total sales}}{\text{Average total assets}}$	$\frac{62,284}{\frac{(44,214 + 50164)}{2}}$ **= 1.320**	$\frac{63,557}{\frac{50,164 + 50,129}{2}}$ **= 1.267**	$\frac{63,406}{\frac{50,129 + 50,781}{2}}$ **= 1.257**
Receivables collection period	$\frac{\text{Average accounts receivable} \times 365 \text{ days}}{\text{Credit sales}}$	$\frac{\frac{2,121+2,190}{2}}{62,284} \times 365$ **= 12.63 days**	$\frac{(2,190+2,525)/2}{63,557} \times 365$ **= 13.54 days**	$\frac{(2,525+2,657)/2}{63,406} \times 365$ **= 14.92 days**
Payables payment period	$\frac{\text{Average accounts payable} \times 365 \text{ days}}{\text{Cost of sales}}$	$\frac{\frac{9,922+10,595}{2}}{64,396} \times 365$ **= 58.15 days**	$\frac{\frac{10,595+11,094}{2}}{59,547} \times 365$ **= 66.47 days**	$\frac{\frac{11,094+11,234}{2}}{59,252} \times 365$ **= 68.77 days**
Inventory turnover period	$\frac{\text{Average inventory}}{\text{Cost of sales}} \times 365\ days$	$\frac{\frac{(2,957+3,576)}{2}}{64,396} \times 365$ **= 18.51 days**	$\frac{\frac{3,576+3,744}{2}}{59,547} \times 365$ **= 22.43 days**	$\frac{\frac{3,744+3,598}{2}}{59,252} \times 365$ **= 22.61 days**

Interest cover	$\frac{\text{Earnings before interest and tax}}{\text{Interest expense}}$	$\frac{-6{,}376 + 661}{661}$ **= -8.646 times**	$\frac{2{,}259 + 564}{564}$ **= 5.005 times**	$\frac{2{,}057 + 517}{517}$ **= 4.979 times**
Financial gearing	$\frac{\text{Fixed interest bearing funds}}{\text{Total capitalization}}$	$\frac{10{,}651}{10{,}651 + 7{,}071}$ **= 0.6010**	$\frac{9{,}303}{9{,}303 + 14{,}722}$ **= 0.3872**	$\frac{10{,}065}{10{,}065 + 16{,}661}$ **= 0.3766**
Capital gearing	$\frac{\text{Common stockholders' equity}}{\text{Fixed interest bearing funds}}$	$\frac{7{,}071}{10{,}651}$ **= 0.6639**	$\frac{14{,}722}{9{,}303}$ **= 1.583**	$\frac{16{,}661}{10{,}065}$ **= 1.655**

SAINSBURY PLC

Ratio	Formula	2015	2014	2013
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	$\frac{4{,}505}{6{,}923}$ **= 0.6507**	$\frac{4{,}369}{6{,}765}$ **= 0.6458**	$\frac{1{,}914}{3{,}115}$ **= 0.6144**
Acid test ratio	$\frac{\text{Current assets} - \text{inventories}}{\text{Current liabilities}}$	$\frac{4{,}505 - 997}{6{,}923}$ **= 0.5067**	$\frac{4{,}369 - 1{,}005}{6{,}765}$ **= 0.4973**	$\frac{1{,}914 - 987}{3{,}115}$ **= 0.2976**
Gross profit margin	$\frac{\text{Gross profit}}{\text{Total sales}} \times 100\%$	$\frac{1{,}208}{23{,}775} \times 100\%$ **= 5.081%**	$\frac{1{,}387}{23{,}949} \times 100\%$ **= 5.791%**	$\frac{1{,}277}{23{,}303} \times 100\%$ **= 5.480%**
Operating profit margin	$\frac{\text{Operating profit}}{\text{Total sales}} \times 100\%$	$\frac{81}{23{,}775} \times 100\%$ **= 0.3407%**	$\frac{1{,}009}{23{,}949} \times 100\%$ **= 4.213%**	$\frac{887}{23{,}303} \times 100\%$ **= 3.806%**
Net profit margin	$\frac{\text{Net profit}}{\text{Total sales}} \times 100\%$	$\frac{-166}{23{,}775} \times 100\%$ **= -0.6982%**	$\frac{716}{23{,}949} \times 100\%$ **= 2.990%**	$\frac{614}{23{,}303} \times 100\%$ **= 2.635%**
Asset turnover	$\frac{\text{Total sales}}{\text{Average total assets}}$	$\frac{23{,}775}{\frac{(16{,}537 + 16{,}540)}{2}}$ **= 1.438**	$\frac{23{,}949}{\frac{16{,}540 + 12{,}695}{2}}$ **= 1.638**	$\frac{23{,}303}{\frac{12{,}695 + 12{,}340}{2}}$ **= 1.862**
Receivables	$\frac{\text{Average accounts receivable} \times 365 \text{ days}}{\text{Credit sales}}$	$\frac{\frac{471+433}{2}}{23{,}775} \times 365$	$\frac{\frac{433+306}{2}}{23{,}949} \times 365$	$\frac{\frac{306+286}{2}}{23{,}303} \times 365$

collection period		**= 6.94 days**	**= 5.63 days**	**= 4.64 days**
Payables payment period	$\frac{\text{Average accounts payable} \times 365 \text{ days}}{\text{Cost of sales}}$	$\frac{\frac{2{,}961+2{,}692}{2}}{22{,}567} \times 365$ **= 45.72 days**	$\frac{\frac{2{,}692+2{,}726}{2}}{22{,}562} \times 365$ **= 43.83 days**	$\frac{\frac{2{,}726+2{,}740}{2}}{22{,}026} \times 365$ **= 45.29 days**
Inventory turnover period	$\frac{\text{Average inventory}}{\text{Cost of sales}} \times 365\ days$	$\frac{\frac{(997+1{,}005)}{2}}{22{,}567} \times 365$ **= 16.19 days**	$\frac{\frac{1{,}005+987}{2}}{22{,}562} \times 365$ **= 16.11 days**	$\frac{\frac{987+938}{2}}{22{,}026} \times 365$ **= 15.95 days**
Interest cover	$\frac{\text{Earnings before interest and tax}}{\text{Interest expense}}$	$\frac{-72+180}{180}$ **= 0.6 times**	$\frac{898+159}{159}$ **= 6.648 times**	$\frac{788+142}{142}$ **= 6.549 times**
Financial gearing	$\frac{\text{Fixed interest bearing funds}}{\text{Total capitalization}}$	$\frac{2{,}506}{2{,}506+5{,}539}$ **= 0.3115**	$\frac{2{,}250}{2{,}250+6{,}003}$ **= 0.2723**	$\frac{2{,}617}{2{,}617+5{,}733}$ **= 0.3134**
Capital gearing	$\frac{\text{Common stockholders' equity}}{\text{Fixed interest bearing funds}}$	$\frac{5{,}539}{2{,}506}$ **= 2.210**	$\frac{6{,}003}{2{,}250}$ **= 2.668**	$\frac{5{,}733}{2{,}617}$ **= 2.191**