"FINANCIAL ANALYSIS"

J Sainsbury plc.

By

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Table of Contents

Introduction

J Sainsbury is a leading food retailer with interests in financial services. Sainsbury's has supermarket, convenience stores, internet based home delivery shopping service and Sainsbury's bank. It has two main segments: food retailing and financial services.

Sainsbury food retail segment serves over 16 million customers a week through its network of 752 supermarkets including 297 convenience stores in UK.

The group financial services segment operates Sainsbury's bank, a joint venture between J Sainsbury and Bank of Scotland (Market Watch, 2006). Refer to Appendix A1 for information on Sainsbury product and services.

This report is divided into three parts firstly it analyse the financial performance of the company based on its Annual Report. Secondly, information from other sources has been evaluated and data from other companies has been compared to reach to a conclusion from an investor point of view. And finally, a short statement about the learning experience of working on this report.

Ratios Analysis of Sainsbury (Micro analysis)

Ratio Analysis provides valuable information about a company's financial structure. Financial ratios are calculated for a company that can be compared with other companies and companies own past figures. For example, if Sainsbury is being studied. It is difficult to judge Sainsbury in isolation, but data from other companies like Tesco and ASDA might be useful comparison (Lofthouse, 2001). At the same time the current data of Sainsbury can be compared with the past data to judge the present performance and earnings of the company. This gives leverage to an investor to judge which company is better for investment. Ratios can be grouped as:

I Profitability	2007	2006	2005
ROCE	6.9%	1.3%	-3.6%
ROE	7.4%	1.4%	-4.5%
GPM	6.8%	6.6%	4.3%
NPM	2.8%	0.6%	-1.5%

Table1 Refer Appendix A2 for calculations

As an investor it is important to judge the corporate earnings. With the help of profitability ratio we can compare the corporate earnings of prospective investment. Profitability ratios:

- Show how profitable is the business
- Measure overall performance
- Examines the profit made by the firm
- Can be used to examine how well the firm is operating, compare the current performance with the past records. (http://www.tutor2u.net/business/presentations/accounts/profitabilityratios/default.html).

Which are based on

1. Return on capital employed- Which shows the % return on the capital invested in the business and measures profit of the business as a % of the capital invested. Capital invested includes Non-Current loans, share capital and reserves. It can be calculated as:

$$ROCE = \frac{\text{Operating Profit (Profit before interest and tax)}}{\text{Capital Employed}} \times 100$$

As it is shown in table 1, Sainsbury's ROCE has increased by 3.9% from 2005 to 2006 and 5.6% from 2006 to 2007. There can be couple of reasons for increase in ROCE.

- Net profit is increasing without an increase in capital employed.
- The cost is reducing while the sales are maintained.
- Sales revenue is increasing without an increase in cost.
- Maintaining the Net profit but reducing the amount of capital needed to generate this level of profit.

(http://www.tutor2u.net/business/presentations/accounts/profitabilityratios/default.html)

2. Return on Equity-

Return on equity shows how much profit a company earned in comparison to the total amount of shareholder equity found on the balance sheet. Example, profit after interest and taxation. (http://beginnersinvest.about.com/cs/investinglessons/l/blreturnequity.htm)

$$ROE = \frac{\text{Profit after interest \& pref. dividends and tax}}{\text{Ordinary share capital, reserves \& retained profit}} \times 100$$

As shown in table1 ROE of Sainsbury has increased by 5.9 and 6% which shows that company has earned a good profit and shareholders willing to invest more money in the company and can get better dividend paid.

3. Gross Profit Margin-

Gross profit is sales less cost of sales which means profit before indirect taxes are taken into account. It shows how many pence out of every pound of sales is gross profit? (http://www.tutor2u.net/business/presentations/accounts/profitabilityratios/default.html)

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit x 100}}{\text{Sales Revenue}}$$

As the gross profit of the firm is increasing it means it will be receiving more gross profit for every pound of sale.

4. Net Profit Margin-

Net Profit Margin shows the profitability after all the costs are included. It shows what % of turnover is represented by net profit. (http://www.tutor2u.net/business/presentations/accounts/profitabilityratios/default.html)

$$\text{Net Profit Margin} = \frac{\text{Net Profit before interest and Tax}}{\text{Sales}} \text{ X 100}$$

Net profit of Sainsbury is increasing which means they are making higher net profit per pound of sale that shows their sales volumes is increasing without an increase in cost. Refer table 1.

II Liquidity Ratio-

	2007	2006	2005
CR	0.71:1	0:49:1	0.59:1
QR	0.5:1	0.67:1	0.48:1

Table2 Refer Appendix A3 for calculations

Liquidity ratio measures how easily a firm can meet its short-term obligations and what is the risk involved. (Lofthouse, 2001) It is based on:

1) Current Ratio- Which shows the, extend to which short term assets cover short-term liabilities.

$$\text{Current Ratio} = \frac{\text{Current assets}}{\text{Current Liabilities}}$$

As shown in table 2 the current ratio of Sainsbury was decreased from 2005 to 2006 which means that their current assets were decreased. This implies that there could be an increase in the investment activities in other projects over that period. But, the ratio was increased from 2006 to 2007 which means that their assets were increased because there was a sharp increase in profit.

2) Quick Ratio- Also, shows the same as above, but excludes inventories, which may be difficult to turn into cash in some circumstances.

$$\text{Quick Ratio} = \frac{\text{Current assets} - \text{inventories}}{\text{Current Liabilities}}$$

As, there is an increase in the quick ratio of the company from 2005 to 2006 it shows that under a circumstance when a company has to pay a short term obligation it has some short term assets that can be converted into cash. And from 2006 to 2007 there is a decrease in ratio which means that company can be investing more in the fixed assets and does not have sufficient short term assets to pay for the short term debts. Refer table 2.

III Gearing Ratio-

	2007	2006	2005
Gearing	36.5%	50%	37.5%
Interest Cover	4.46 times	0.67 times	1.8 times

Table3 Refer Appendix A4 for calculations

It measures of how heavily a company is in debt. Because debt gets the first call on resources, how geared or safe the shareholder's returns are. (Lofthouse, 2001)It is based on:

a) Gearing- shows the debt's weight in the capital employed. For example Long-term lease agreements involve fixed payments and may be added to both Non-current debt and capital employed.

$$\text{Gearing} = \frac{\text{Non- Current debt}}{\text{Capital employed}} \times 100$$

There is a decrease in gearing ratio from 2005 to 2006 which means they had many debts to pay. Therefore, from an investor point of view it can be risky to invest money. However, there is a decrease of Sainsbury's Gearing ratio from 2006 to 2007 which means it's less risky to invest money this year as the company does not have many debts to pay. Sainsbury has created more capital this year by issuing shares and assets have been increased over liabilities. Refer table 3.

b) Interest Cover- this ratio calculates how business can cover the interest payments.

$$\text{Interest cover} = \frac{\text{Profit before interest and tax}}{\text{Interest charges}}$$

As shown in table 3 this ratio is reduced from 2005 to 2006 which shows that the company does not have sufficient profit to pay interest to its debtors.

However the ratio has improved from 2006 to 2007 this shows that the company has sufficient profit to pay interest to its debtors.

IV Investment Ratio-

	2007	2006	2005
EPS	19.2 p	3.8 p	3.5 p
DC	1.9 times	0.4 times	0.44 times
P/E	28	86.5	85
DY	1.7%	2.4%	2.6%

Table4 Refer Appendix A5 for calculations

This ratio is used by the investor to assess the performance of a business as an investment. The commonly used investor's ratios are:

i. Earning per Share-EPS measures the overall profit generated for each share in existence over a particular period.(http://www.tutor2u.net/business/accounts/main_ratios.htm)

$$EPS = \frac{\text{Profit availability to equity shareholders}}{\text{Number of ordinary shares in issue}}$$

According to the financial statement of Sainsbury the company has issued more shares in all the three years that's a reason the EPS has increased in 2006 and 2007. The profit has increased with the, increase in the number of shares.

ii. Price Earning- This ratio is an indication of how high or values of a business. P/E ratio is best viewed in the context of a sector or market average to get a feel for relative value and stock market pricing. (http://www.tutor2u.net/business/accounts/main_ratios.htm)

$$PE = \frac{\text{Market Share price at bal. sheet date}}{\text{Earning per share}}$$

This ratio relates the earning per share to the share market price, and so could change on daily basis. The price earning ratio has increased in 2006 this means that the market want to invest in Sainsbury. The ratio has dropped in 2007 although the earning per share rose. The share price only rose by 218 p causing a fall in this ratio. So, it can't be assumed that the market does not want to invest in Sainsbury. Refer to table 4.

iii. Dividend Yield- It shows the ability of business to maintain a dividend payment. It also measures the proportion of earnings that are being retained by the business rather than distributed as dividends. (http://www.tutor2u.net/business/accounts/main_ratios.htm)

$$\text{Dividend Yield} = \frac{\text{Dividend per share}}{\text{Current Market price}} \times 100$$

As shown in table 4 the dividend paid per share has been increased from 7.8 to 8.00 p in 2006 and to 9.75 p in 2007. It shows the company's ability to pay the dividend to its shareholder's is increasing.

iv. Dividend Cover- This ratio shows the number of times the earning per share cover the dividend per share.

$$\text{Dividend Cover} = \frac{\text{Earnings per share}}{\text{Dividend per share}}$$

This has increased 1.5 times because the EPS and DPS had increased from last year.

By looking at all the ratios it can be analysed that Sainsbury is expanding and making a good mark in business. The companies profit and sales revenues are increasing without an increase in cost. However, during the year 2005 to 2006 their expenses were more still they are able to reduce the debts. The share price is increasing and they are able to pay dividends.

Sainsbury in comparison with others (Macro analysis)

In order to gain more solid understanding of Sainsburys as a potential target for investment, in this section, we are going to compare and contrast between Sainsburys and other British supermarket giants. To start with, we will give an overview of the business environment that Sainsburys is operating in and followed by a close analysis of its market position and business performance in comparison with Tesco and Morrison by using financial ratios. A conclusion will be based on result of this analysis. Let's start with macro-business environment.

Because the business is operating within an economic political and social institutional framework, it is important for us to gain an insight into the macro environment before moving onto analyse the individual market. General speaking, UK has one of the largest market based economies in the world, in 2006, it ranked sixth in terms of total GDP PPP by World Bank (2007). It is also one of the wealthiest countries. For 2006, International Monetary Fund (2007) placed UK eleventh in term of GDP PPP Per Capital with an average of US$ 35, 486 per head per year. The UK economy has been performing well in the past decade with a sustained annual economic growth (average GDP growth rate 2%), low inflation (average 2%), interest (average 4%) and unemployment rates (3%). (CIA, 2007) The good economy performance associates with high average personal income are clearly shown in the retail business. According to the latest figure from the British Retail Consortium (BRC), that UK retail sales in November 2007 has once again risen 1.2 per cent on a like for like basis, compared with the same time last year. This has offered a good macro-environment for Sainbury's and all other British supermarket chains to operate in.

At the micro level, as we can see from the table 5, despite a small percentage increase between 2006 and 2007, Sainsburys is currently the third in terms of market shares with a close gap of only 0.5% to Asda. Morrisons is followed by with an average of 11%.

Table 5 2006 and 2007 UK Market Shares in Supermarket Sector

	12 weeks to 03 December 2006	12 weeks to 02 December 2007
Tesco	31.5%	31.7%
Asda	16.5%	16.6%
Sainsbury's	16.0%	16.1%
Morrisons	11.1%	11.3%

Source: TNS Worldpanel (quoted in IGD Retail Analysis, December 2007)

In terms of profitability, table 6 is clearly shown an improvement for Sainsburys over the last three years. The capital invested in the business generates an increasing rate of capital return (profits). However, this compares with Tesco, the differences remain vast. Morrison on the other hand, was enjoying a huge increase in the profits during the financial year of 2007 after a downturn of 2006, this was largely due to the successful integration of former supermarket chain, Safeway. (Morrison 2007) With the absence of ASDA, Sainsburys becomes the third in raising the profits among the top four.

Table 6 ROCE Ratios for Sainsburys, Tesco and Morrisons From 2005 to 2007

	2005	2006	2007
Sainsburys	-3.60%	1.30%	6.90%
Tesco	13.08%	14.77%	15.93%
Morrisons	3.22%	-5.55%	6.69%

Sources: those ratios were calculated based on Annual Reports from Sainsburys, Tesco and Morrisons.

The table 7 is showing a similar picture. While Sainsburys was recovering quickly over the last three years, Tesco is enjoying the position as a market leader in return of profits relating to the sales. Morrisons is catching up too and pushed Sainsburys to the third in 2007.

Table 7 Net Profit Margin Ratios for Sainsburys, Tesco and Morrisons From 2005 to 2007.

	2005	2006	2007
Sainsburys	-1.56%	0.6%	2.8%
Tesco	5.59%	5.66%	6.22%
Morrisons	1.59%	-2.57%	2.96%

Sources: those ratios were calculated based on Annual Reports from Sainsburys, Tesco and Morrisons

The table 8 is showing the liquidity ratios, in the current part, in comparing to Tesco and Morrisons, Sainsburys has got a relatively higher rate in the latest figure (2007). After taking off of the stock that has been held by each supermarket chain, the liquidity ratio of Sainsburys is almost doubted to Tesco and five times higher than what it is for Morrisons. This has implied a possibility that Sainsburys is inefficient in using of its funds to re-invest in the further business activities.

Table 8 Liquidity Ratios for Sainsburys, Tesco and Morrisons From 2005 to 2007

	2005	2006	2007
Sainsburys	0.59:1	0.49:1	0.71:1
Tesco	0.57:1	0.53:1	0.56:1
Morrisons	0.77:1	0.45:1	0.41:1

Quick Ratio	2005	2006	2007
Sainsburys	0.48:1	0.67:1	0.50:1
Tesco	0.34:1	0.33:1	0.32:1
Morrisons	0.05:1	0.06:1	0.12:1

Sources: those ratios were calculated based on Annual Reports from Sainsburys, Tesco and Morrisons

As we can see in the table 9, despite a decrease from 50% to 36.5% between 2006 and 2007, Sainsburys still has a highest rate of gearing ratios in contrast to the other two. This means that Sainsburys has a larger proportion of business activities that were funded by a third party outside the company. In contrast, Morrisons has got a lowest rate. This has increased the business risk for Sainsburys.

Table 9 Gearing Ratios for Sainsburys, Tesco and Morrisons From 2005 to 2007

Gearing	2005	2006	2007
Sainsburys	37.53%	50.00%	36.5%
Tesco	40.21%	37.01%	35.22%
Morrisons	33.15%	35.27%	28.81%

Sources: those ratios were calculated based on Annual Reports from Sainsburys, Tesco and Morrisons

Finally when we look at the earning per shares (table 10), Sainsburys has improved its share performance significantly between 2006 and 2007 while Tesco is enjoying a relatively stable share prices over the last three years and Morrisons was improving itself too.

Table 10 Earning Per Share for Sainsburys, Tesco and Morrisons from 2005 to 2007

	2005	2006	2007
Sainsburys	-17.4	3.8	19.2
Tesco	17.30	19.92	23.31
Morrisons	4.12	-9.46	9.31

Sources: those ratios were calculated based on Annual Reports from Sainsburys, Tesco and Morrisons

Based on the above comparison, despite the undeniable fact that business performance for Sainsburys has been improving in recent years thanks to the recovery programme that was launched by Justin King, Sainsburys' CEO in 2004 (Sainsburys 2007). Sainsburys still has a long way to go to become a market leader once again in terms of its market shares and its ability in raising the profits. Liquidity ratios in comparison with other two major supermarket chains have shown a sign of inefficiency in using of its available funds. Gearing ratios indicated that Sainsburys has got a highest business risk amongst the top three. All of those figures are showing that Sainsburys is not good to be a potential target for investment. And therefore needs to be considered twice.

Conclusion-

From an investor point of view if we compare the performance of Sainsbury only from past three years we can say that it is growing as a company. It is earning high revenue. They are increasing the shares in the market and the market is interested in investing the money. There is a major improvement if we compare the data from 2005 to 2007. There is a constant increase in all the ratios. However, liquidity ratios can be a point of concern but the company is making money so it does not impact much. The gearing ratio has decreased which is most important for an investor which means that the company does not have many debts to pay. The interest cover ratio is increasing which is also good as company is capable to pay interest to its debtors. Therefore, based on all these figures it can be analysed that Sainsbury is making good amount of profit and is capable of paying good amount of dividend so it is beneficial for an investor to invest in this company.

However, if we compare the performance of Sainsbury with other major supermarkets chains of UK it can be said that Sainsbury is still far behind TESCO. Supermarkets like Morrison is also giving a good competition to Sainsbury. The ratio figures of all the other firms are also attractive. In the competitive market, investors have wide choice of investments. Therefore, from an investor point of view, when a comparison has done, it can be beneficial to invest in other firms as well.

Word counts: 2658(Excluding All Headings, Tables and Biblography)

Individual Statement - Kavita Bhalotra

Working on this report was an excellent experience for me. As we were required to work in pair's it made the educational task very enjoyable. The advantage of working together is that it promotes participation and enhances the learning. It gave me an opportunity to get an experience to work with a person from different community and region. While working together we shared some personal experiences and learned some different management and educational skills of each other's countries. In starting we discussed about the assignment, than made a plan on how we can divide our work then we organised and collected the information we needed together. Working in a group made the work simple as it gave me a leverage to work according to my skill. My partner was helpful and supportive and gave me time and space to utilize my skills in a proper manner. My partner also guided me throughout. We motivated each other. I learnt time management and learnt to become more responsible. Then we divided the work and at the end combined the work in one product. It was really helpful to have a partner as we could share each others ideas. At any moment one person was acting as a driver and other as a navigator. After working in a group I became a good listener, started giving more importance to others ideas. I am encouraged to participate in a team for any task. It boosted my confidence and helped in improving my communication skills as well as the mode of communication between us was English.

Individual Report – Kai Jiao

In this report, I worked with Kavita Bhalotra as a team. The most important thing I have learnt throughout this task was on how to work in a team.

By definition Team work is a magic combination of people with different skills working together towards a common goal. (Buelens et al 2006) Thus for us, as a team, we have to share a goal together in relation to the work. In this case, it was to produce a report. Then we need to:

1. Allocate the task according to the individual interests and skills
2. Do our own part accordingly
3. Formulise our work with everyone's input

Throughout the task, it is very important for us to

1. Co-operate with each other: help my colleague out with the task whenever it is needed and respond promptly to her requests.
2. Treat each other with respect
3. Solve the problems together: as soon as a problem arises, tackle it straight away. To do so, we need to talk about the problem with my colleague, then formulise a solution together and learn from the experience.
4. Communicate with each other openly and honestly
5. Take the responsibility to get things done

As the result, I believe that we have produced a good work.

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Appendixes

A1:

Major Products and Services
Food Retailing:(30,000 products) Food and Grocery Product Delicatessen Meat and Fish Pharmaceutical Drugs Alcoholic Beverages Books and Gift Items Computer Paraphernalia Coffee Shops Sainsbury Bank: Health Coverage Products Life Coverage Products Instant access savings accounts Direct saver account Visa credit cards Personal loans Car financing packages Car insurance Home insurance Travel insurance Pet care insurance

Source company spotlight: J Sainsbury Plc, Market Watch 2006

A2: Profitability Ratio

ROCE	2007 477/6855x100 =6.9%	2006 104/7937x100 =1.3%	2005 -238/6582x100 = -- 3.615%
ROE	324/4349x100 =7.4%	58/3965x100 =1.4%	-187/4112x100 = - 4.547%
Gross Profit Margin	1172/17151x100 =6.8%	1067/16061x100 =6.6%	658/15202x100 = 4.32%
Net Profit Margin	477/17151x100 =2.8%	106/16061x100 =0.6%	-238/15202x100 = - 1.56%

A3: Liquidity Ratio

2005	2007	2006	2005
Current Ratio	1940/2721 =0.71:1	3845/4810 =0.49:1	2988/5036 =0.59:1
Quick Ratio	(1940-590)/2721 =0.5:1	(3845-576)/4810 =0.67:1	(2988-559)/5036 =0.48:1

A4: Gearing Ratio

Gearing	2506/6855x100 =36.5 %	3972/7937x100 =50%	2470/6582x100 =37.5%
Interest Cover	477/107 =4.46 times	104/155 =0.67 times	-238/132 = - 1.8 times

A5: Investment Ratio

	2007	2006	2005
Earning Per Share	19.2 p	3.8p	3.5p
Price Earning	548.5/19.2 =28	330.8/5.85 =86.5	297/3.5 =85
Dividend Yield	9.75/548.5x100 =1.7%	8.00/330.8x100 =2.4%	7.8/297x100 =2.6%
Dividend Cover	19.2/9.75 =1.9	3.8/8.00 =0.4	3.5/7.8 =0.44

Source: Sainsbury's Annual Reports 2006-7 [Available from http://www.j-sainsbury.co.uk/?pageid=201] [Accessed on 3 December 2007)