

Abstract

This report is based on financial analysis of two sports fashion manufacturers and retailers in the United Kingdom, JD Sports plc against Sports direct plc. The purpose of this findings is to evaluate whether JD Sports is worth investing at the current market price. The Annual Financial Reports and key performance indicators will be used to measure to obtain accurate financial analysis of the performance of JD Sports. The findings based on current financial data shows that JD Sports' performance remain healthy and it is worth investing at the current share price. The numbers indicate that JD Sports plc will grow exponentially in the future.

Introduction

JD Sports was founded in 1981 by John Wardle and David Makin. It was established from a single store in North England and incredibly, in October 1996, the company was first listed on the London Stock Exchange. In year 1989, JD Sports have established their first London store at Oxford Street ([Jdplc.com](http://jdplc.com), 2019). In October 1996, JD Sports was listed on the London Stock Exchange.

By December 2001, JD Sports have successfully acquired nearly 200 further stores with the purchase of First Sport from Blacks Leisure Group. Repeatedly in October 2005, the company has purchased 70 stores from the administrators of Allsports, and in May 2005, the Pentland Group has bought Wardle's and Makin's shares for GBP 44.6 million. Both David John and David then decided to resign from the board. Fascinatingly, in December 2007, the company bought out banks stores, that sold fashion clothing for around GBP 19million.

JD Sports have a very unique business module in the UK where they are the first official supplier and sponsor of numerous association football teams, players and associations. JD Sports have also successfully signed a sponsorship deals with Bournemouth, Charlton athletic, Dundee United, Blackpool, Luton Town & Oldham Athletic in August 2008 ([En.wikipedia.org](http://en.wikipedia.org), 2019).

In year 2015, JD Sports' first half profits increased more than 80% to an amazing record of GBP 46.6 Million due to the boom on high street fashion in trainers and sneakers. JD's shares have doubled in price during the same year and since then becoming the British retailing's success stories ([Farrell](#), 2019).

FINANCIAL ANALYSIS

This section of this report will be identifying and analyzing JD Sports Plc year on year growth from 2015 – 2019 by comparing with Sports Direct Plc 2019. The main reason of this financial analysis is to provide clear financial aspect recommendation to the investors whether it would be profitable to invest in the shares of JD Sports plc. According to an online website – independent UK, "the group mentioned that profit margin has stayed stagnant as the previous year due to the company's policy – not to enter into short-term reactive discounting without cause" ([The Independent](#), 2019).

Table 1: Profitability Ratios of JD Sport Plc (2015 – 2019) and Sports Direct Plc (2019)

JD Sports Plc	2015	2016	2017	2018	2019	Sports Direct Plc 2019
Sales (£m)	1,552.30	1,821.70	2,378.70	3,161.40	4,717.80	3,701.90
Sales Growth (%)	27.62	17.35	30.58	32.90	49.23	10.19
Gross Profit	739.60	884.2	1163.6	1531.6	2243.3	1583.5
Operating Profit	92.7	133.4	239.8	295.9	346.2	160.5
Profit/Net income	69.8	100.6	184.6	236.4	264.2	116

Source: Annual Financial Reports of JD Sports Plc and Sports Direct Plc

Based on the above table, it is rather impressive that the sales numbers of JD Sports have increased year on year. The revenue in 2018 rose by 32.9% during the period of when most fashion sectors have been struggling ([Halliday and Halliday, 2019](#)). The success of the company is due to the internal factors where JD Sports have expanded its store footprints with more space in the UK, with an increase of 18 stores in mainland Europe. The online spend in JD sports is one of the major factors for the profit jump. Additionally, JD positioned itself alongside professional football clubs such as Blackpool FC and supplying trainers for the field. The sales incentives, promotions, and competitions with celebrities and influencers are creating excitement as a brand as it reinforces youthful appeal ([LLP, 2019](#)).

Gross profits and Operating profits are driven by sales where Sports Direct's profit are significantly lesser than JD Sports. Looking at the table, although Sports Direct's sales growth for 2019 is at 10.19%, the Gross Profit indicates that the numbers are extremely healthy. It could be due to numerous factors such as, low administrative expenses, low cost of sales and low overhead costs. The numbers for Sports Direct could be due to the company maximizing sales on the online environment.

JD Sports Plc	2015	2016	2017	2018	2019	Sports Direct Plc 2019
Gross Margin (%)	47.65	48.54	48.92	48.45	47.55	42.78
Net Profit Margin (%)	4.50	5.52	7.76	7.48	5.60	3.13
Operating Margin (%)	5.97	7.32	10.08	9.36	7.34	4.34

Source: Annual Financial Reports of JD Sports Plc and Sports Direct Plc

As stated above, Gross and Operating margins are driven by sales. In 2019, Gross Margin for JD Sports has reduced slightly in comparison to 2018. This is a result of the dilution from the newly acquired businesses, predominantly Finish line and Sport Zone. According to the annual report, the reduction of gross margin is an opportunity for JD Sports to reduce levels of markdowns to raise gross margins in the future. Additionally, the movement in margin could be related to the foreign exchange contracts.

The net profit margin is a measurement that reveals the amount of profit that a business can extract from total sales. The reduction of Gross margin has drastically impacted JD Sport's net profit margin. This could be due to extensive discounts and offers in store and online. JD Sport's operating margin has reduced in 2019 in comparison 2018. Based on the financial report of JD Sports, the significant increase in cost of sales, income tax, administrative expenses, are some of the attributes affecting the gross and operating margin.

Table 2: Efficiency Ratios of JD Sports Plc and Sports Direct Plc

JD Sports Plc	2015	2016	2017	2018	2019	Sports Direct Plc 2019
Sales (£m)	1,552.30	1,821.70	2,378.70	3,161.40	4,717.80	3,701.90
Total Asset (£m)	683.00	791.30	1,178.94	1,626.20	2,205.50	3,148.80
Fixed Asset (£m)	147.93	173.32	235.76	376.90	539.80	823.20

JD Sports Plc	2015	2016	2017	2018	2019	Sports Direct Plc 2019
Asset Turnover	2.27	2.30	2.02	1.94	2.14	1.18
Fixed Asset Turnover	10.49	10.51	10.09	8.39	8.74	4.50

Source: Annual Financial Reports of JD Sports Plc and Sports Direct Plc

The asset turnover is the ratio of total sales to average assets, this metric would greatly assist to identify the effectiveness of a company using assets to generate sales. This tool is excellent to recognize if JD Sports are making the use of the assets and simultaneously distinguishing the company's weaknesses. From the data provided above, it is clear that JD Sports have invested a hefty sum in property/ plant/ equipment in year 2019 in comparison to 2018. The JD Group has invested in various retail outlets, offices, warehouses, plant and equipment under non-cancellable operating lease.

Companies with high profit margins have low asset turnover (Collier, 2009). JD Sports' asset turnover is relatively low, so it means that the company makes a high profit on the products, but have low profit margin in return. Asset Turnover in year 2019 has increased slightly highly impacted by fixed asset turnover, indicating that the company is generating sales via the assets.

Table 3: Liquidity Ratios of JD Sports Plc and Sports Direct Plc

JD Sports Plc	2015	2016	2017	2018	2019	Sports Direct Plc 2019
Current Asset (£m)	400.26	510.69	714.17	971.80	1,192.20	2,031.10
Current Liability (£m)	326.75	348.15	535.16	682.30	900.50	598.50
Inventory (£m)	225	238.32	348.01	478.00	763.80	978.40
Cash (£m)	121	216	247.56	347.5	251.2	448

JD Sports Plc	2015	2016	2017	2018	2019	Sports Direct Plc 2019
Current Ratio (£m)	1.22	1.47	1.33	1.42	1.32	3.39
Quick Ratio (£m)	0.54	0.78	0.68	0.72	0.48	1.76

Source: Annual Financial Reports of JD Sports Plc and Sports Direct Plc

The current ratio and the quick ratio are used to assess the cash position of the company. The current ratio is a liquidity ratio to measure a company's ability to pay short-term obligation which are usually due in one year. It provides an indication to the investors how the company can maximize the current assets on the balance sheet to satisfy current debts and other payables. Ratios under 1 suggests that company may struggle to pay off its obligations (Gurufocus.com, 2019).

Presently in 2019, JD Sports has a current ratio of 1.32, it reflects on the company's good short term financial strength. On the other hand, Sports Direct has a ratio of 3.39 demonstrating that the company is at its excellence with financial strength.

Quick ratio indicates the company's ability to use its near-cash assets to pay its current liability. When measuring the liquidity, it can be argued that inventories are not included in the quick ratios as it takes roughly 90 days to convert to cash in the short-term without compromising on pricing. Therefore, only accounts receivables which are money owed to the company within a 90 days' period shall be taken into consideration. The quick ratios are declining year on year due to the current liabilities in JD Sports. JD Sports have high amount of debts over the years that requires to be paid off. The company has a high amount of equity which is rather positive, which means the company is able to pay off short-term debts.

However, Sports Direct has very high current and quick ratio, which means that they are able to make use of company assets to liquidate into cash rapidly.

Table 4: Gearing Ratios of JD Sports Plc and Sports Direct Plc

JD Sports Plc	2015	2016	2017	2018	2019	Sports Direct Plc 2019
Total Debt (£m)	37.00	6.58	33.96	37.80	126.00	826.50
Total Equity (£m)	310.00	382.42	552.25	770.40	1,008.80	1,246.60

JD Sports Plc	2015	2016	2017	2018	2019	Sports Direct Plc 2019
Gearing Ratio (%)	10.66%	1.69%	5.79%	4.68%	11.10%	39.87%

Source: Annual Financial Reports of JD Sports Plc and Sports Direct Plc

The fundamental of calculating the gearing ratios are to analyse the financial structure of the business (ICAEW, 2012).

Gearing ratio is a type of financial ratio that compares debt and equity. The term debt is rather straight forward where in finance it defines as "borrowing", borrowing funds from a finance organization such as the bank. Equity on the other hand refers to the lenders such as a borrowing method from the shareholders or company owners.

Based on table 4, in year 2015, JD sports' total debt was significantly high in comparison to year 2016. In this scenario, it represents the health of this company when the company decides to make use of equity to clear of the debts hence in year 2016, the gearing ratio was 1.69%. In 2017, JD sports have acquired the Go Outdoors business hence increasing its gearing ratio to 5.79%. In year 2019, the company has acquired more retailers and businesses to generate more income hence higher debt resulting high gearing ratio. The statement of financial situation of two businesses are significantly affected by their different capital configurations.

Advice on Investors regarding the purchase of JD Sports Plc

Investors major concern in respect of the investment in the shares of the company is to be able to earn a good return rate of investment. Based on the analysis above, JD Sports Plc is fundamentally a profitable business. The sales growth in 2019 by 49.23% indicates the strength of JD Sports year on year. JD sports has its unique selling proposition in the market where they utilize the up and coming sportsmen to appeal the younger market. JD Sports are currently performing well in terms of their financial aspect due to the creative marketing, online growth, and unique retail sites.

Though the quick ratio is below 1, the company has demonstrated over the years that despite of debts which are mainly due to acquiring new businesses, the company has sufficient equity to pay off debts. JD sports' debts are short term as it generates profit with asset turnover.

A company generating earnings before its tax and interest at least three times are considered financially stable. In JD's scenario, the ratio suggests that interest is comfortably covered, this only means that lenders are more inclined to lend more money into the business as it has produced a reliable financial trajectory in terms of payback.

Based on the considerations above, the report acknowledges that there are low risks involved with the investment of JD Sports Plc. The future returns of JD Sports Plc are expected to outweigh any sort of short term risks. Therefore, the report recommends investors to purchase the shares of JD Sports Plc.

Part C

The research below of two different companies are to provide an extensive financial advice to the investors for a range of new investment opportunities.

Year	Projected Cash Flows (£m)	
	A	B
0	-80	-75
1	25	50
2	25	20
3	20	20
4	55	20

Cost of Capital	Cost of Capital/100	1 + Cost of Capital/100
9.75	0.0975	1.0975

In order to present a recommended analysis to the investors to invest in one of the projects, the decision will be made based on financial analysis. The financial analysis is based on the below calculation;

The payback period:

The payback period is best defined as the time it takes to receive cash flows sufficient to cover the initial investment.

Account Rate of Return:

This is a ratio to measure the income where the investors are expected to make. It is definitely important to analyse the risk involved in contributing to the investment.

Net Present Value (NPV):

NPV is used in investment planning and capital budgeting to analyse the profitability of a project.

Internal Rate of Return:

This is used to measure the return of an investment in comparison with other projected investment.

Table 1: Payback period (Project A & Project B)

Project A				Project B			
Year	Cash Flow	Depreciation	Total Profit	Year	Cash Flow	Depreciation	Total Profit
0	-80			0	-75		
1	25	-20	5	1	50	-18.75	31.25
2	25	-20	5	2	20	-18.75	1.25
3	20	-20	0	3	20	-18.75	1.25
4	55	-20	35	4	20	-18.75	1.25

Pay Back Period (Year)	
Project A	Project B
3,181,818.182	2.25

Table 2: Accounting Rate of Return (Project A & Project B)

Project A				Project B			
Year	Cash Flow	Depreciation	Total Profit	Year	Cash Flow	Depreciation	Total Profit
0	-80			0	-75		
1	25	-20	5	1	50	-18.75	31.25
2	25	-20	5	2	20	-18.75	1.25
3	20	-20	0	3	20	-18.75	1.25
4	55	-20	35	4	20	-18.75	1.25

ARR	0.28125	28.13%
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ARR	0.23333333	23.33%
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Accounting Rate of Return formula = $(\{\text{Profit year 1} + \text{2} + \text{3} + \text{4}\} / 4) / (\text{Investment} / 2)$

Table 3: Net Present Value (Project A & Project B)

Cost of capital (CP %)	CP/100	1+CP/100
9.75	0.0975	1.0975

Project A				
Present Value (PV)	22.78	20.76	15.13	37.91
Future Value (FV)	25	25	20	55
Nº Year	1	2	3	4

Total Present Value	96.57
Net Present Value	16.57

Project B				
Present Value (PV)	45.56	16.6	15.13	13.79
Future Value (FV)	50	20	20	20
Nº Year	1	2	3	4

Total Present Value	91.08
Net Present Value	16.08

Net Present Value formula = $-\text{Investment} + \text{CF1}/(1+r)^1 + \text{CF2}/(1+r)^2 + \text{CF3}/(1+r)^3 + \text{CF4}/(1+r)^4$

Table 4: Internal Rate of Return (Project A and Project B)

Project A

Year	Cash Flow	Depreciation	total profit
0	-80		
1	25	-20	5
2	25	-20	5
3	20	-20	0
4	55	-20	35

Cost of capital (R1)	CP/100	1+CP/100
17.8	0.178	1.178
Cost of capital (R2)	CP/100	1+CP/100
18	0.18	1.18

Present Value (PV) for R1	21.22	18.02	12.23	28,56
Present Value (PV) for R2	211864407.00	179546107.00	1217261745.00	283683881.00
Future Value (FV)	25.00	25.00	20.00	55.00
Nº Year	1.00	2.00	3.00	4.00

Total Pv1	80.03	Total Pv2	7968205701.00
NPV1	0.03	NPV2	-0,317942991

Internal Rate of Return	0.18	17.80%
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Project B

Year	Cash Flow	Depreciation	Total Profit
0	-75		
1	50	-18.75	31.25
2	20	-18.75	1.25
3	20	-18.75	1.25
4	20	-18.75	1.25

Cost of capital R1	CP/100	1+CP/100
21.5	0.215	1.215
Cost of capital R2	CP/100	1+CP/100
21.7	0.217	1.217

Present Value (PV) for R1	41.15	13.55	11.15	9.18
Present Value (PV) for R2	41.08	13.50	11.10	9.12
Future Value (FV)	50	20	20	20
Nº Year	1	2	3	4

Total Pv1	75.03	Total Pv2	74.8
NPV1	0.03	NPV2	-0.20

Internal Rate of Return	0.2153	21.5251%
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Internal rate of return formula = $R1 + \frac{\{NPV1 \cdot (R2 - R1)\}}{NPV1 - NPV2}$

1. Recommendation

Based on Table 1, the finance research indicates that the payback period of Project B is preferable as it is under 3 years whereas the payback period for Project A is approximately 3 years.

The account rate of return indicates that Project A has a better return value at 28.13% within year 3, whereas project B takes approximately 4 years to achieve 23% of account rate of return. What this implies for the analysis is that ideally Project A is much suitable for the investors to invest in. However, it has not taken in consideration that time value of money.

When analyzing the Net present value of both projects in Table 3, the investors will have higher rate of returns in Project A in comparison to Project B. However, when analyzing at the internal rate of return stated on Table 4 along with net present value, project B has strong cash flow than Project A. Addition to that, Project B has a higher Internal Rate of Return at 21.5%.

In conclusion, based on the overall analysis using financial ratios such as the net present value, and the internal rate of return where these ratios have been proven to provide the most accurate advice on financial investment, this report concludes with siding Project B where it encourages the investors to look into investing on the company. The other factor to consider in this research analysis is that the time value of money is extremely crucial for a larger firm in comparison to a smaller firm.

2. Advantages and shortcomings of PBP, NPV, and IRR

The payback period is the cost of investment divided by the annual cash flow. The shorter the payback, it would be more desirable for the investors to invest on the project. Obviously, the longer the payback, the less desirable it would be for the investors. Therefore, it is crucial to use payback period to measure the liquidity of a project (*Daunfeldt and Hartwig, 2014*). The only problem with the payback period is that this ignores the time value of money. There are some larger firms use the payback method to select the most profitable project to invest in however the downside of payback as mentioned is that it does not measure the time value of money.

Net present Value, Account rate of return and internal rate of return are perfect for measuring time consuming calculations based on the discounted cash flow as it should have been taken into consideration.

NPV is used to analyse the profitability of a firm or a projected investment. For instance, money now is worth more than the same amount in the future. This is due to the inflation and earning from various investments. Basically, a dollar earned in the future won't worth as much as the present value.

IRR is best used in a project to evaluate capital investment and capital budgeting (*Andrews and Bulter 1986*). Lastly, a successful company is known to select capital investment when looking into obtaining long term profits.

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