

Finance Mangement

LCM B7002



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Introduction

As a supermarket, Sainsbury got a long history behind where has built a great brand that at the moment is one of the bigger suppliers of food and other goods around the UK, from the beginning of this century the company has a rebuilding stage where they went through different moments that make the groups decide for next steps, as this work has got his focus into the last 5 years of the company starting from 2015 Sainsbury as a step into the new technologies the brand launched an innovations systems click and collect that give to the customer the option to order online their purchase and collect them on the shop to avoid the long queue.

After that in 2016 was a big year for Sainsbury as was the year when they completed a great deal by the acquisition of different brands including Argos from there as a consequence The new Sainsbury group got organized into 4 different divisions Core Sainsbury food retail, General Merchandise, Financial services and various property investments, apart of during that year and the following year Sainsbury promote the use of a new sales system called collection and purchase points online but not all was good news since in the last quarter of 2016 the group announced a reduction in its business levels that would mean that in the following year the group had to reduce its workforce with the dismissal of thousands of employees as a final result.

Following this line the group in 2018 tried to make a movement by merging with Walmart group which was planned to be led by the Chief Executive of Sainsbury that could not go through as it was against the Competition Markets Authority, to reflect how the structures are at the moment from the beginning of the 20th Century Sainsbury was changing their Chief Executive and chairmen but from the last 10 years their structure started to be stable as there were no effective change over the senior's positions except the one that has produced in 2019

As I have said previously from 2019 to day to day Sainsbury has not suffered or made any relevant change that has the impact to Sainsbury structure apart of few stores that especially the ones that are dedicated to a new technology which are no need to keep open as they are no need by following the rules that the government has imposed due to the current covid crisis 19.

Research Methodology

The first thing before I deeply describe all the measures I will need to get a general vision of Sainsbury for that reason is because I use the financial report which will develop an explanation from where are coming all the number to calculate the ratios that is what I am explaining in the following chapters, to get a proper idea how good or bad is doing any company or bussiness that is why I should check his finanacial report from few yeas to approach a better knowdledge of them and be able to aproach recomendations to the future steps and also comparison Sainsbury's position with the competitors, any Financial resport covers 52 or 53 weeks in order to draw a complete and defined picture or idea of the specific company, including the units of measurement such as profitability, liquidity solvency and operational effeciency and gearson, by this measures I will dispay a real position of Sainsbury against the competition and then a trend analaysis will clarified and give me a idea how to deal with the disadvanmtages to finally developing recommendations that will allow Sainsbury's to grow financially and thus enable it to aspire to more competitive global targets.

Ratios Analysis

Profitability

By Profitability, I understood that is the measure that gave us how better any company is making earning that is why it is including the gross margin and the return on Assets, as the magnitude will give a relative vision of Sainsbury, following this definition will analysis them by individual description to get a better idea of Profitability as the mind force.

First of all the **Gross margin** is the valid index to measure how much is generating any business from any individual purchase that the customer is doing, As an example if Sainsbury is selling a pair of shoes for 10 pounds and they have produced them for 7 pounds the gross margin for any purchase of those shoes will be 3 pounds which is the difference between the cost of this product and the final price that the customer will buy it.

In our case, our brand Sainsbury is a great position in the market against their competitor also is getting a better place as is making a progress by getting away from the principal competitor Tesco.

The other side of the formula is integrated by the **Return on Assets**, this says is showing the capacity of any business to generate benefits from their active.

Liquidity

As liquidity to describe it for a company is how quickly any brand can liquidate its liabilities to its assets, concerning this ratio in the main supermarkets such as Sainsbury Tesco or Morrison they have very low ratios, which implies the speed or ease of The same to balance their balances, in this indicator two imposing ratios play the Current ratio and the quick ratio that I will proceed to examine

First, the **current ratio** shows the capacity that any company got of paying their obligations by providing the proportion between the actual asset and their liabilities it means as higher results will tell that the company can easily generate enough cash to pay off their debts.

As It shows at the calculate Sainsbury since 2015 is increasing her Currents Ratio by being in a better position than their competitions by increasing the level of their assets and declined the liabilities which means Sainsbury from 2018 is the first when they got the best Current ratio against the one that Morrison shows up in her Reports.

Secondly, I will define the **quick ratio** as the name is meant this is an indicator of liquidity that show how any company is meeting their liabilities in a short time in other words how quick any assets can be converted into cash in a short time, It is calculated by divided the currents assets between the current liabilities and the result will tell me how long does any company need to recover in this case, Sainsbury.

Solvency

First of all, to meet this new measure I will define it comparing with the previous one (liquidity), as I exposed previously liquidity is the effort or capacity that any company in this case Sainsbury has to respond or cover the obligations in a short time it means for a short period which will affect his targets for a small-time but to define the solvency It will affect the capacity or effort that Sainsbury has to do it to cover his financial debts in a long period like which can be a tax year, over this unit of measure it had included two ratios, firstly the Debt to Equity Ratio

On this ratio are playing two ratios:

First the Debt to equity ratio, this ratio is calculated by the next operation which is the total liabilities divided by the total equality once I have got the results will tell me how the company or Sainsbury is growing aggressively with the debts, It means with a higher debt to equity ratio means a higher interest expense which at the moment Sainsbury has a medium level of D/E ratio in comparison with his competitors.

Secondly, the Total Debt to Total Assets is a ratio which tells me how the company has acquired and expanded to the assets gradually rather than the one before which is accomplishing how a company finances its assets by borrowing, following this definition I can deliver that as much high is the ratio the more risk have any company would take in investment, following the rates that Sainsbury has against his competitors I can conclude this chapter saying that all of them has similar rates which give us a stables position for them on the market.

Continuing with the measures of financial analysis, I will now describe **operational efficiency**. It is the unit of measurement that shows the efficiency in the profit of any company based on the cost operations, that is to say, that the higher the rate obtained, the higher the profit margin that company will have. Two important factors play a role in it, on the one hand, the **asset turnover** that shows how many sales a company can generate from each pound in assets and is calculated by dividing sales revenue by the average of total assets. Focusing on this parameter my company is having an upward trend for the last two years but still below Tesco but above its main competitor which is Morrison.

The second parameter that is included in **operational efficiency** is inventory turns which can be defined as how many times a company replenishes its inventory during the year which depends on

how many sales the company makes during the year and is derived by dividing the cost of goods sold by the average stock during that period of time.

The last measure that I will proceed to the examination will be the **gearing** which works a bit separately from the other measure, this financial measure will give us a real knowledge of the capital structure of the company by having in consideration two relevant factors by one hand will have the business funding that comes from the borrow method it means the whole amount of money that the company has need to make the company working and the other side is including by the shareholders or company owners that are the mindset of any company.

After we have calculated the ratio I will be able to make the right decision regarding the future steps of Sainsbury as it will help you to see if the credits are extended to keep making bigger the company or no and either way to determine whether or no invest the business.

Payback Period , Accounting Rate of Return And Net Present Value

Starting with the last part of my assessment I will analyse the following two projects that it has been introduced to the company as an investment to the choice between them they are two formula or two theory method that will give enough knowledge to make the best decisions to Sainsbury, from there on let's break them down to first decide which project is better by being examined behind these two methods.

First I will get a quick definition of them to make clear where are different between them and how they work, firstly the **payback period** as I have mentioned is a financial method to evaluate different projects and decide which one I should choose by evaluating the risk. It means the risk is the potential or mind factor that will determine how good or bad is a project to the business, the formula to calculate the payback period is dividing the initial investment that is the amount of money that cost the investment divide by the amount that you will recover during each year and the result will tell me how long do I need to recover my investment and from that moment the company will generate profit. It means as smaller is the result will say that will take a shorter period to recover our investment.

To clarify much better which project is the best options for the company The financial statement has got another method or formula to make easier the life to any owner who wants to choose a healthy and satisfying decision for the goodless of the company which is called **Accounting Rate of Return** this method, this formula has a specific name that covers the meaning of it as different from the payback period it has in consideration individually how much the company is recovering yearly in comparison with the first method that uses a permanent amount of money per year, in other words, the payback does not make any difference from the first year of the recovery and the last year to cover the initial investment which means Payback method is easier to use and calculate but no close with the reality as there are many factors around that can change the yearly recover amount that the Accounting Rate of Returns has part of his formula.

After the deeply and theoretical explanation, I will compare both methods with the practical example that is included in the task that is being given to me to do it; but first I will get what advantages and disadvantages both methods have for that I will treat both methods as general speak to evaluate them in common, the ARR is a method is based on the cash flow instead of the profit where such items like the rate of the depreciation are used to calculate the rate, also the ARR fails to take into the account the timing of the profit and although the payback period is focused in a short-term and It is no considering the cash flow which is a mistake as any project can generally cash by indeterminate time furthermore than the time when the company has to recover their initial investment.

First let bring the number to make a clear idea of the case

Projected Cash Flows (£m)

Project	A	B
0	-85	-90
1	10	25
2	20	30
3	40	35
4	55	40

Assume that the company's cost of capital is currently at 10.5 per cent.

Following the dates let calculate first all the dates and then and a real comparison between both methods to approach a knowledge which project is the best option for the company, first, let calculate the Payback period and Annual Rate of Returns to each project.

As the number is showing me the project A following the method Payback period The company will need 3 years + $(15/55) = 3.27$, It means the company will need 3 years and almost in the third part of the fourth year to recover the investment however the project B will take exactly three years to get back the whole investment that the company has made it on the year 0, it means by the payback period the project B is more successful for the company than the A project.

Now I will do the same discussion with the ARR method, by the next two tables I will display an examination of both projects by the Accounting Rates of Return formula, first as the table is showing up I am calculating the total cash inflows which is the total amount of cash that the company is recovering during the four years that the project is taking place, then I will calculate the total profit which is the difference between the last date against the initial invest then I will get the average annual profit which is the media of cash that the company is getting from the investment then I will use this amount to calculate the two final approach which is calculated by dividing the average annual profit with the average capital employed (calculated by the total invest adding the residual valor in half) to get the first approach and finally we can get a second approach by using the total investment instead of the average capital employed. Over the formula explanation, there is a new concept which is the residual valour which is the rest valor of the investment after the company has recovered it which in this case is 0 as the projects have not valor after it has come up to the end.

Project A:

	Cash flow	
Year 0		-85
Year 1		10
Year 2		20
Year 3		40
Year 4		55
total cash inflows:	$10+20+40+55=$	125
total machine cost:		85
total profit:	$125-85=$	40
average annual profit:	$40/4=$	10
Average capital employed:	$(85+0)/2=$	42.5
ARR (ROCE): Approach 1	$10/42.5=$	0.24

Initial capital employed: 40
 ARR (ROCE): Approach 2 $10/85 = 0.12$

Project B

	Cash flow	
Year 0		-90
Year 1		25
Year 2		30
Year 3		35
Year 4		40
total cash inflows:	$25+30+35+40=130$	
total machine cost:	90	
total profit:	$130-90=40$	
average annual profit:	$40/4=10$	
Average capital employed:	$(90+0)/2=45$	
ARR (ROCE): Approach 1	$10/45 = 0.22$	
Initial capital employed:	45	
ARR (ROCE): Approach 2	$10/90 = 0.11$	

Net Present Value

Another method to help the companies to make a decision between different projects where they can invest their money is the Net Present Value this method is used to determine the current value of all your future cash flow generated by a project, including the initial investment, in other words, the formula did make different depend on how much the company is recovering each year that's why the formula can fluctuating in order of the consistency of the cash flow, following this analysis I will proceed to calculate it:

$$\text{Project A: } -85 + \frac{10}{1 + 0,11} + \frac{20}{(1 + 0,11)^2} + \frac{40}{(1 + 0,11)^3} + \frac{55}{(1 + 0,11)^4}$$

$$-85+9,01+16.26+29.20+36.18=5.65$$

$$\text{Project B : } -90 + \frac{25}{1 + 0,11} + \frac{30}{(1 + 0,11)^2} + \frac{35}{(1 + 0,11)^3} + \frac{40}{(1 + 0,11)^4}$$

$$-90+22.52+24.39+25.55+26.32=8.78$$

Having both rates calculated let's get a joint vision of both rates to approximate a clear knowledge to decide between both projects, as the calculate are saying the project B has a bigger NET value in comparison with project A that means that Project B is better as following the explanations by having a higher rate than the other project will make to decide for the project that his value is bigger in this case Project B.

Comparative Financial Analaysis

In this chapter I will do examination analytics of the whole situation of Sainsbury at the current market by including all the dates that I am collecting during the previous chapters, Firstly, looking at the profitability ratios in its first ratio as can be seen in the table below, Sainsbury has been improving its market position considerably since 2016 coinciding with the incorporation of Argos to the company and thus seeing its sales increase in comparison with its main competitors, which in reference to the **gross margin ratio** I can affirm that with respect to some of its competitors such as Tesco, which is close behind, however, its latest major competitor Morrison has seen its sales decline considerably in the last 3 years.

Sainsbury's	2016	2017	2018	2019	2020	Morrisons 2020
Sales (exc VAT)m	23506	26224	28456	29007	28993	17536
Sales Growth (%)	-0,01	11,56	8,51	1,9	-0,00048	-0,01
Gross profit	1456	1634	1882	2288	2294	629
Operating Profit	700	642	518	601	650	521

On another side of the profitability, I do have **the return on Assets** that Sainsbury is no doing well especially since 2017 to 2018 that as I can say from the annual report of Sainsbury had been an incredible decrease of the net incoming every year, however, at the same time the company was spending huge amount money on acquiring assets with the negative result as Morrison being on top of Sainsbury and also to Tesco.

Sainsbury's	2016	2017	2018	2019	2020	Morrisons 2020
Operating Profit Margin	3,0	2,4	1,82	2,0	2,3	2,9
Gross profit Margin	0,061	0,062	0,066	0,078	0,079	0,035
Net profit Margin %	1,98	1,43	1,08	0,75	0,52	1,40
Return on equity %	7,39	5,48	4,16	2,58	1,95	8,98

The next ratio to have in consideration is the **Liquidity** over this measure the financial analysis is taking two ratios firstly the **Current Ratio** where Sainsbury has improved a lot on the last few years by getting the first glance against their competitors as the current level of assets has increased and being accompanied by a clear decrease in their liabilities, but this great performance does not make a huge difference with the competitors as their activities in this measure is doing also on the same way by established the assets and liabilities main points that the current ratio is using to be the final result.

At the **quick ratio** as the following the table I get an overview of Sainsbury in comparison to its competitors in this regard Sainsbury since 2015 has maintained an average position between Tesco which is better placed and Morrison's which is on a downward trend however as far as our company is concerned Sainsbury has improved significantly since 2017 to catch up with Tesco as its liabilities ratio has improved which means that Sainsbury is now recovering faster in the short term than it was previously.

Sainsbury's	2016	2017	2018	2019	2020	Morrisons 2020
Current Ratio	0,660	0,736	0,762	0,637	0,629	0,388
Quick Ratio	0,516	0,529	0,586	0,475	0,485	0,45
Cash Ratio	0,170	0,126	0,167	0,094	0,082	0,099

Solvency

Under this ratio following the theory explication that I did previously made and reflecting with the number and dates from the annuals reports I can display the next affirmation firstly on the D/E ratio Sainsbury has a medium satablished position against their competitors as from 2016 is borrowing a lot of amount in based of the expansion that the company is suffering by the main adquisition or Argos on the mean time the Brand the Total equity has also increased which will be the reason why the D/E ratio would go slow down , in realtion with the competence Tesco has a better postion that Sainsbury but in a perspective or decline since 2017and the last one is Morrison who has a worst ratio probably by the decresiang of her liabilities.

Operational Efficiency

As I did explained early the operational Efficiency is based into two ratios firstly the asset turnover where Sainsbury following the number from the previous five years the best supermarket is Morrison with a clear upward trend since the beginning of 2017 that puts it in a great position in contrast to Sainsbury's, which is in the middle of its two main competitors but with a negative and declining dynamic since 2018, which is mainly due to a potential increase in the total assets, therefore, It may be conclude that Sainsbury is holding obsolete assets and lacks of efficient debt, the other ratio that treat the operation efficiency as I mentioned earlier is the Inventory turnover inventory where I can appreciate that Morrison replace the inventory more frequently since 2016 and 2018 in composition of Sainsbury that his ratio has decreased from 22 to 15 times It can only mean something reflected in the annual sales where his sales has increased but the may estimated higher demand than the actual sales that the company has marked during the tax year.

Sainsbury´s	2016	2017	2018	2019	2020	Morrisons 2020
Asset Turnover	1,400	1,324	1,293	1,035	1,037	1,605
Fixed Asset Turnover	2,407	2,620	2,874	2,987	3,253	2,453

Gearing

Following the definition that I have done previously Gearing is the measure which will say how much fund the company is using from the debts or loans to make success itself instead of using the shareholders equity in the business, from this definition there are two possibility that the company can take; the first one is having a high grade of Gearing which means the company has an huge amount of debts in his capital structure from the Annual reports I can affirm that Sainsbury in the past five year Sainsbury has a remarkable position in this area as part of the recuperation that is suffering from 2016 where the company made the acquisition of Home Retail hat was part of Argos It means his actual rates are lower than 2016 it means the amount of debt into his capital is smaller so I can define the situation of Sainsbury against his competition is suitable against Morrison as the previously tables is shown, in the other side there is the stable position so the company or firm will not have loans against it so it will depend on the cash from its activities. To more clarification if any company got a higher level of gearing It can come from two vias first that the company is using the money of the shareholders or they are borrowing a high amount of money which can only end up in a very bad final as the company can go to bankrupt as they have more passive activity than the amount of cash that they can generate against their finance obligations.

Sainsbury´s	2016	2017	2018	2019	2020	Morrisons 2020
Gearing ratio (%)	19,95	16,41	6,88	7,82	3,89	22,90
Debit Equity ratio	1,67	1,87	1,97	1,78	2,59	1,41

Conclusion

To close up this report and make my point of view firstly I will make a review of everything that I did go through, the report or assessment is divided into two-part the first one where I have to use the financial ratios to get a real imagine how is the financial situation of Sainsbury by adding a theoretical describe where I have provided different points of view from the authors that have treated all the ratios, then I did calculate three differents methods to approach which project is more viable in financial terms It means which one is the project where the company will get back

the cash that they have invested by comparing the amount that the company or firm is recovering each year from the day that they started the project.

After the theoretical analysis and the practical analysis as the last chapter of this report I can say that Sainsbury is established by following the whole analysis that I have been through and from today's days and for the future steps, the company should keep improving at the delivery skills to destroy the king of this area who is Amazon.

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