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I confirm that this assignment is my own work, is not copied from any other person's work (published/unpublished), and has not been previously submitted for assessment elsewhere.

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DATE: 22 Dec 2022

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Introduction

This paper is a thorough analysis of accounting information that provides a perspective on the financial and accounting health of the company and includes all angles from a financial reporting and shareholder perspective. The company chosen is Sainsbury, a large corporation described in the introductory assessment. This analysis will be thorough, and procedures will be explained using valuation methods for assertions such as profitability, efficiency, short-term solvency, long-term solvency, and market-based metrics.

1.Performance Evaluation

1.1 Profitability Ratio

Particulars	Formula	2022	2021	2020	2019
Profitability Ratio					
Gross Profit Ratio					
Gross Profit		2,366	1,845	2,294	2,288
Sales		29,895	29,048	28,993	29,007
GP ratio	**GP / Sales**	**7.91%**	**6.35%**	**7.91%**	**7.89%**
Net Profit Ratio					
Net Profit		677	-201	152	186
Sales		29,895	29,048	28,993	29,007
Net Profit Ratio	**NP/Sales**	**2.26%**	**-0.69%**	**0.52%**	**0.64%**

Table 1: Profitability Ratio

(Source: Refer to excel sheet no. 1)

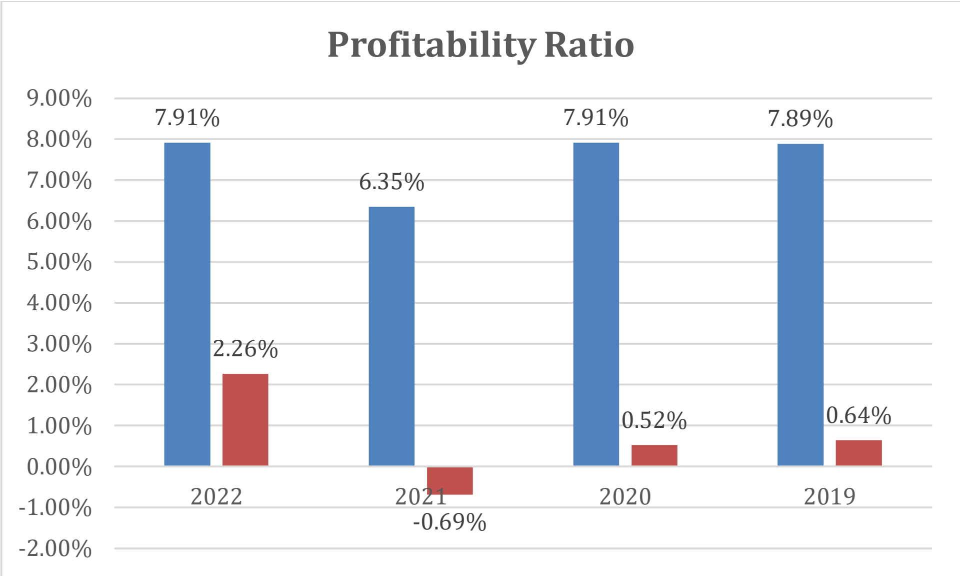

Figure 1: Profitability Ratio

(Source: Refer to excel sheet no. 1)

The above table is the calculation of Sainsbury's for the last four years, i.e. 2022, 2021, 2020 and 2019. The company generates a very low gross profit margin, which also affects the net profit. The company's revenue figures have increased in 2022 compared to the other three years 2021, 2020 and 2019. It was also noted that the company's GP will increase by almost 28% in 2022 compared to 2021. At the same time, the revenue has also increased by 2.83% (Sainsbury's, 2022). This shows that the company has not been able to increase its gross profit compared to the increase in sales. Thus, this also affects the net profit of the company in each year. In 2021, the company must incur a loss, which can be attributed to the pandemic that will hit the world in 2020-21. As a result, the net profit ratio is also low.

1.2 Efficiency ratio

Particulars	**Formula**	**2022**	**2021**	**2020**	**2019**
Efficiency ratio					
Inventory Turnover Ratio					
Cost of Goods Sold		27,529	27,203	26,977	26,719

Average Inventory		1711	1,679	1830.5	1869.5
Inventory Turnover Ratio	**COGS/Inventory Turnover Ratio**	**16.089**	**16.207**	**14.738**	**14.292**
Asset Turnover ratio					
Sales		29895	29048	28993	29007
Average Assets		26086	26598.5	9119.5	22771
Asset Turnover ratio	**Sales/Average Assets**	**1.15**	**1.09**	**3.18**	**1.27**

Table 2: Efficiency Ratio

(Source: Refer to excel no. 1)

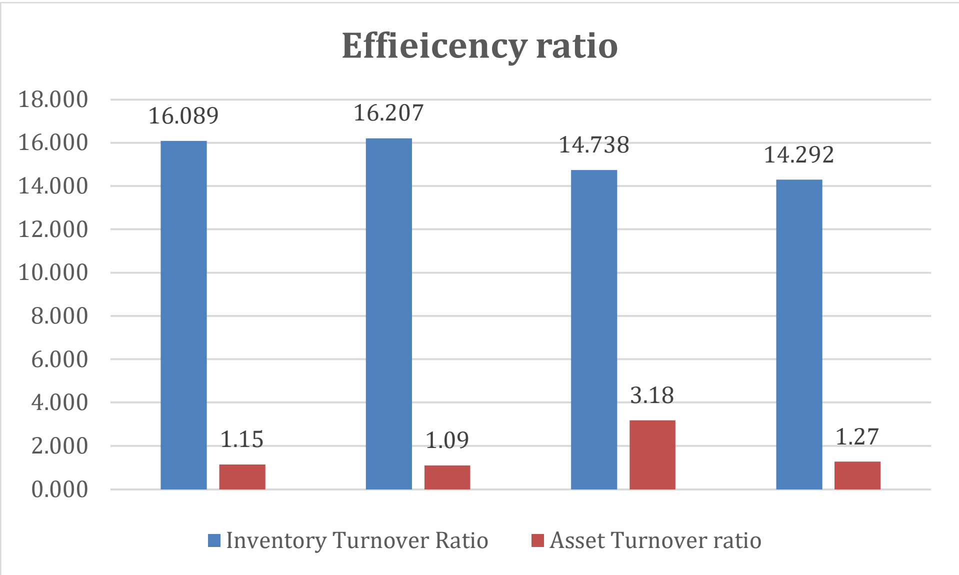

Figure 2: Efficiency Ratio

(Source: Refer to excel no. 1)

The efficiency of the company was calculated using the inventory turnover rate and the asset turnover rate for the last four years. The inventory turnover ratio shows how much inventory the company is liquidating to generate revenue. The higher the inventory turnover ratio, the better the financial health of the company. The inventory turnover ratio of Sainsbury's has increased in the last four years from 2019 to 2022 (sainsburys, 2022). This shows that the company has managed to increase the turnover. However, the COGS of the company has also increased, which also affects the turnover. Therefore, the inventory turnover ratio in 2022 is lower than in 2021. In addition, the asset turnover ratio shows the use of assets to generate sales in each year. The asset turnover ratio shows that the company's revenue from assets decreased in 2022. This is due to the increase in both assets and sales.

1.3 Short Term Solvency

Particulars	Formula	2022	2021	2020	2019
Short Term Solvency					
Current ratio					
Current Assets		6,742	7,147	7,582	7,550
Current Liabilities		9,868	11,829	12,050	11,849
Current Ratio	**Current Assets / Current Liabilities**	**0.68**	**0.60**	**0.63**	**0.64**
Quick Ratio					
Current Assets		6,742	7,147	7,582	7,550
Inventories		1,797	1,625	1,732	1,929
Current liabilities		9,868	11,829	12,050	11,849
Quick Ratio	**(Current Asset - Inventories) / Current liabilities**	**0.50**	**0.47**	**0.49**	**0.47**

Table 3: Short term solvency Ratio

(Source: Refer to excel no. 1)

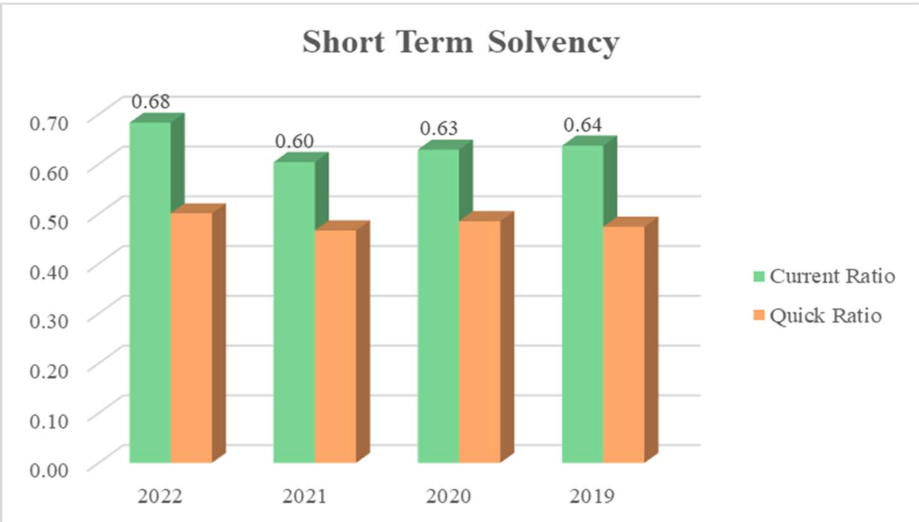

Figure 3: Short term solvency Ratio

(Source: Refer to excel no. 1)

Short-term solvency is also referred to as the company's liquidity ratio. It has been shown that the current ratio of the company is very low and does not meet the ideal value of 2:1 (Ball et al., 2020). Since the current ratio is very low, this indicates that the company's current liabilities are greater than its current assets. The company is not able to pay its current liabilities as quickly as possible from its current assets. In addition, the Quick Ratio indicates the company's ability to pay off its current liabilities without drawing on its inventories. The ideal quick ratio is 1:1, which Sainsbury's has not achieved in the last four years. The company has very low current assets without drawing on inventories.

1.4 Long term Solvency Ratio

Particulars	Formula	2022	2021	2020	2019
Long term Solvency Ratio					
Debt to equity ratio					
Debt		54	356	48	816
Equity		8,423	6,701	7,773	7,782
Debt to equity ratio	**Debt / Equity**	**0.64%**	**5.31%**	**0.62%**	**10.49%**
Debt Ratio					
Total Liabilities		18,489	18,559	20,146	20,229
Total Assets		26,912	25,260	27,937	28,011
Debt Ratio	**Total Liabilities / Total Assets**	**68.70%**	**73.47%**	**72.11%**	**72.22%**

Table 4: Long term solvency Ratio

(Source: Refer to excel sheet no. 1)

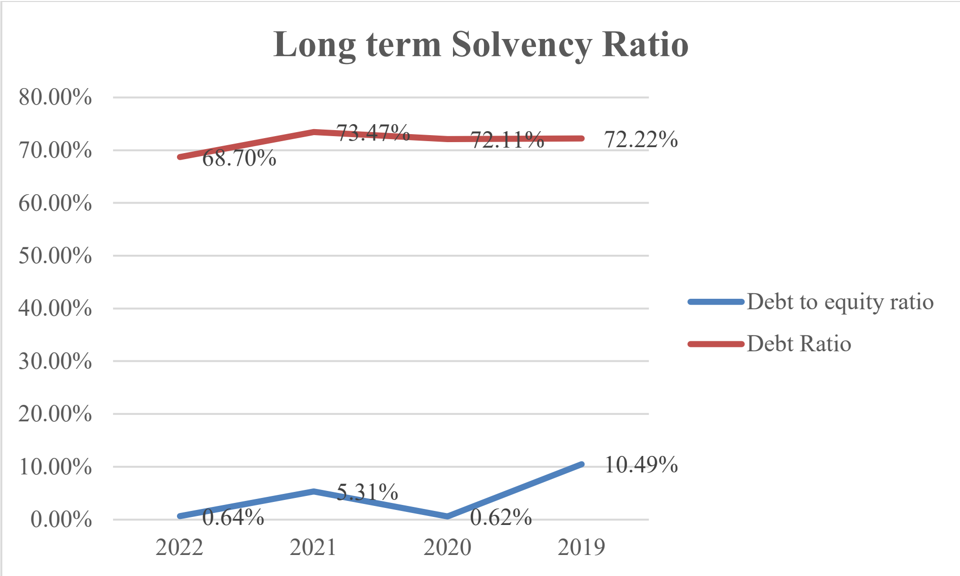

Figure 4: Long term solvency Ratio

(Source: Refer to excel sheet no. 1)

The long-term solvency of the company is related to the debt and equity ratio. The debt of the company shows the weakness of the capital strength compared with the equity and assets of the company (Fischer et al., 2019). The above table shows Sainsbury's debt to equity and assets ratio. The company has a low debt to equity ratio. The percentage of debt to capital structure in 2019 was 10.49%, which is the highest in the last four years. It was gradually reduced over the years until 2022. This means that the company was able to raise sufficient capital from the issuance of equity. On the other hand, the ratio of debt to assets will decrease to 68.70% in 2022. This indicates that the company has been able to use its assets efficiently and that debt is not being used too much for business expansion.

1.5 Market Based Ratio

Particulars	Formula	2022	2021	2020	2019
Market Based Ratio					
PE ratio					
EPS		5.8	7.6	29.8	-9.4
Share price		248.9	238.6	210	235.7
PE ratio	EPS/Share Price	2.33%	3.19%	14.19%	-3.99%
Dividend yield ratio					

Cash Dividend per share		13.1	10.6	3.3	11
Market Price per share		248.9	238.6	210	235.7
Dividend yield ratio	Dividend per share/Market price per share	5.26%	4.44%	1.57%	4.67%

Table 5: Market based Ratio

(Source: Refer to excel sheet no. 1)

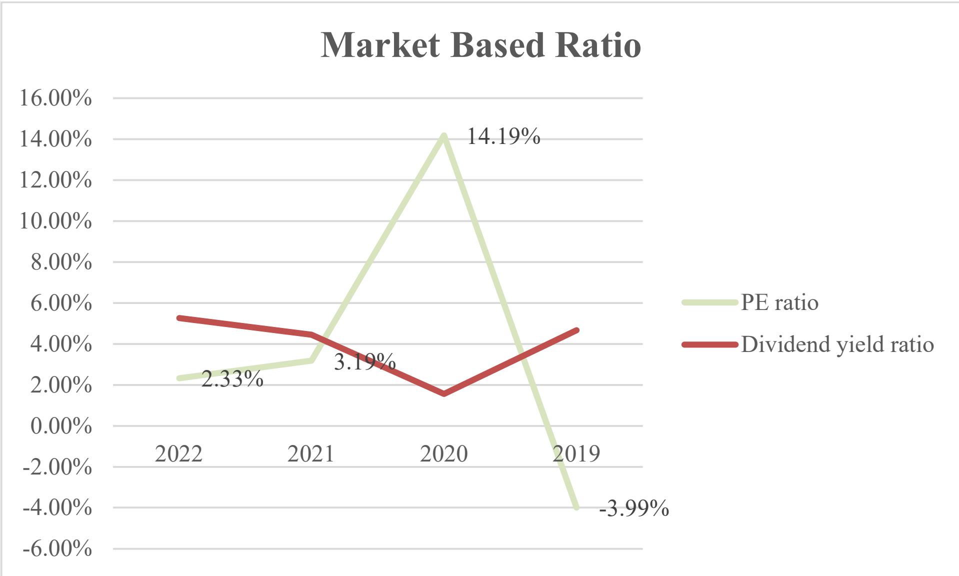

Figure 5: Market based Ratio

(Source: Refer to excel sheet no. 1)

The company's PE ratio shows the price it has spent to earn a pound. The higher the PE ratio, the better it is for shareholders. The company's stock price has gradually increased over the last four years. The company has also maintained a low EPS for the last two years. As the highest EPS was achieved in 2020, the PE ratio is also higher in this year (about.sainsburys.co.uk, 2022). Shareholders could not pay more for the shares in 2022 than in 2020. Also, the dividend yield ratio was calculated to understand the amount of dividend paid by the company compared to the share price it charges for each share in the market (economictimes.indiatimes.com, 2022). It has been shown that the dividend yield has increased to 5.26% in 2022, which means that the company is in a good position to pay a better dividend to the shareholders as it is between 2% and 6%.

2. Recommendation for improvement

2.1 Improvement of profitability

Boost the prices

Sainsbury's has a natural inclination to lower prices to remain competitive, but in reality this would have a dramatic negative impact on the company's profitability. If the company were to lower the prices of its products, it would have to sell more products and attract more customers to maintain the same level of earnings as before (bgateway.com, 2022). Normally, this is only effective in very specific stores where the prices of goods are very competitive.

More customers are needed

Attracting new customers can be difficult, but it is an excellent way to increase company sales and improve profitability. By increasing its customer base, Sainsbury's not only increases its revenue, but also expands its network by gaining a brand-new contact who would ideally return for more goods or services (bgateway.com, 2022). Targeted marketing is usually necessary to reach new consumers and markets. There are several ways to advertise, including handing out flyers on the street, airing commercials on TV, and using digital marketing. Sainsbury's should choose a strategy that is appropriate for the company's retail industry and target market.

2.2 Improvement of efficiency

Increment in Revenue

There are several ways Sainsbury's can increase revenue, but the simplest way is to serve more customers. One solution is to raise prices, which is always an option (Reimink, 2018). The market can only handle so much, and the value of the product or service provided by Sainsbury's is determined by the price customers are willing to pay. Another way to increase sales is to offer consumers the best possible retail products. Sainsbury's can serve them faster in this method because time is money. The company can serve more customers with the same resources if it works more efficiently.

Reduce Expenses

The simplest solution is to ensure that the company's costs are as low as possible. Perhaps Sainsbury's should consider where money is being wasted. Sainsbury's staff is probably the company's most important resource and biggest cost. Staff time is usually the biggest cost. It would be better to ensure that their time is used as effectively as possible to maximize their productivity than to try to cut these expenses.

2.3 Improvement of short-term solvency

Limiting overhead costs of Sainsbury's

By bargaining or shopping around, the company may be able to save money on a number of overhead costs, such as rent, electricity, and insurance. Sainsbury's can audit where the company spends its time and energy (Khasanov, 2022). For example, going digital can help the company save time and money that would otherwise be spent depositing and accepting paper checks if the company has a paper trail.

Selling of any unused assets

For example, eliminating redundant commercial equipment can bring in some capital and reduce the average cost of maintaining the equipment.

Improvement of long-term solvency

Up sales of the company

In the medium to long term, strengthening Sainsbury's sales and marketing initiatives can significantly increase the company's revenue. This means that more money will flow to the company, which Sainsbury's could use to reduce its high debt burden.

Boost profitability

It does not help to attract more customers if the company has a lot of sales but only a small profit margin on each one. Instead, Sainsbury's should focus on increasing the profit margin on each shop. This might involve raising prices or focusing on sales with higher profit margins.

Raising Owner Equity

Sainsbury's can immediately reduce its debt-to-equity ratio by investing some of its own money in the company. The company can invest more in growth and/or paying down debt. A poor liquidity and solvency ratio will make it difficult to attract new investors. However, if conditions are favourable enough, the company may be able to convince current investors to invest more money.

2.4 Improvement of market-based ratio

Expansion of Market

A potential buyer will think about the marketability. Therefore, be sure that the Sainsbury's market is expanding or has the potential to expand. If Sainsbury's is in a declining industry, the company must either reverse that trend or look to expand into a growing industry. Diversifying the business to add a new revenue stream and improve cash flow will help increase the value of the business in the eyes of a buyer (corporatefinanceinstitute.com, 2022). This is important because a profitability study is one of the first things a potential buyer would look for.

Changing of Market Position

Given the feasibility of the business model, there is sufficient demand for the product or service that Sainsbury's provides. The company could expand by adjusting its market positioning, such as:

- Sainsbury's could expand and attract new customers by becoming more upscale and continually improving its offerings and discounts.
- The company could expand by targeting a larger market and producing lower-priced, mass-market replicas of its largest goods under a new brand name.

Regular market research is important

A potential buyer might have numerous questions when Sainsbury's acquires another company. The company can protect its value by showing that it knows its market and routinely studies future changes. This shows buyers that the company is not static and can adapt to change.

Establishing mechanisms to monitor the business climate and obtain valuable customer information about changing needs can help Sainsbury's stay on top of the retail market. Planning early to anticipate problems can help the company develop a great, consistent track record.

3. Investment appraisal techniques

3.1 Weighted Average Cost of Capital

Sainsbury has recently decided to invest money in expanding its business in India. For this purpose, the company has decided to invest part of the funds from retained earnings and part from a bank loan. The company has total equity of £8423 million in 2022. The company will be able to raise 40% of the total capital, which means that the company will raise £3369.2 million. Sainsbury's management has decided to raise these funds from retained earnings and a bank loan.

Sources	Amount (£' million)	cost	Weight	Cost * weight
Loan @ 10%	1369.2	0.1	0.4063872729	0.04063872729
Retained earnings	2000	0.15	0.5936127271	0.08904190906
	3369.2		1	0.1296806364
weighted average cost of capital	12.96806364			

Table 6: Weighted average cost of capital

(Source: Refer to excel)

A company's weighted average cost of capital (WACC) determines its average after-tax cost of capital, which comes from a variety of sources. These sources may include preferred stock, retained earnings, stock, bonds, bank loans, and others. In this case, the company used retained earnings and bank loans to finance its investment process (Cui et al., 2022). The company's return on equity was assumed to be 15%. The cost of retained earnings is determined based on the cost of equity. Therefore, the cost of retained earnings was also assumed to be 15%. The company has withdrawn £2000 million from retained earnings. In addition, the company used £1369.2 million from a loan taken out at an interest rate of 10%. On this basis, the weighted average cost of capital was calculated at 12.96%. This indicates that this project will be profitable for Sainsbury's in the future. Reducing the cost of equity or changing the capital structure to include more debt are the most effective approaches to minimise the WACC. This is because the cost of equity indicates the risk to generating future net cash flows, so reducing the risk characteristics of the business will also reduce this cost.

The most important factor affecting a company's cost of capital is its capital structure, dividend policy, income tax rate, and more. The ratio of debt to equity affects the company's weighted average cost of capital. When debt is higher than equity, the cost goes up. And when share capital exceeds debt, the cost of equity must be paid. On the other hand, Sainsbury's, like any other company, has huge capital and financial needs, a dividend, and an associated policy. The total income of a company is the amount paid as dividends to bondholders. Each fiscal year, the company's management calculates these expenses and communicates the information to the owners so that payments can be made.

3.2 Net Present Value

Year	Cash flow (£ ' million)	Discount rate (10%)	Present Value of cash flow (£' million)
1	1125	0.909	1022.625
2	235	0.826	194.11
3	458	0.751	343.958
4	1000	0.683	683
5	200	0.621	124.2
6	236	0.564	133.104
7	1452	0.513	744.876
8	1233	0.466	574.578
9	896	0.424	379.904
10	900	0.385	346.5
Present value of cash inflow			4546.855
Less: Present value of cash outflow			3369.2
Net present value			1177.655

Table 7: Net Present value

(Source: Refer to excel)

The net present value method determines the difference between the present value of the cash inflow and the present value of the cash outflow (Notch & Kusto, 2018). The NPV method formula is present value of cash outflow - present value of cash inflow. The discount rate for this project is 10%. The initial investment of the company for the new project was £3369.20 million. Based on the calculation, the net present value of this project is £1177.655 million. According to the net present value rule, only those projects should be selected whose net present value is greater than 1. Projects with NPV less than 1 should not be selected. Based on this NPV, it can be said that Sainsbury can invest in this project because it will generate higher returns in the future

So, in terms of weighted average cost of capital and net present value method, this project is profitable for Sainsbury. By expanding in India, Sainsbury will be able to run its business profitably and expand its market in this country.

4. Whether or not the company should use its own cash or return in earnings

Retained earnings can be defined as the portion of corporate profits that is set aside by the organisation after dividends have been distributed to shareholders (Ajmal, Saleem, & Zaheer, 2022). This portion of retained earnings is used for the company for other purposes, such as future expansion or uncertain relationships

Retained earnings are important to a firm for a number of reasons. First, retained value improves the company's stock price. Higher retained earnings mean a higher number of shares, which also improves the company's balance sheet. It also shows that the company has sufficient funds to better deal with uncertain situations (Fischer et al., 2019). It also allows the company to grow at a high rate. Sainsbury can use its retained earnings to fund research and development activities or to fund sustainable and CSR policies. In the context of each of these aspects, retained earnings can be of great benefit and Sainsbury should not use retained earnings to fund its projects

Even though Sainsbury's makes a profit by taking in more than it spends, the company must properly manage its cash flow to be successful. The company's cash flow is related to its operating or commercial activities, its investing activities, such as the purchase or sale of capital goods, and its financing activities, such as the raising of debt or equity or the repayment of such funds. The funds generated from the company's operations are related to the company's primary business activities and provide the best opportunities for cash flow management (Viet et al., 2020). As with other companies, liquidity is the lifeblood of Sainsbury. The company needs to generate enough cash from operations to cover its expenses while having enough left over to compensate investors and develop the business. While Sainsbury's profits can be manipulated, cash flow provides insight into the true health of the business

That being said, borrowing may be the easier alternative for the company, but the interest rate on those loans may be higher. Also, if Sainsbury borrows, there is a possibility that shareholders will move to other companies, as higher financial expenses mean higher risks for the company. Higher financial expenses always mean that the liquidity position of the company will deteriorate (Ball et al., 2020). Moreover, the cost of issuing bonds is also high and it might be difficult for the company to manage them. If Sainsbury decides to issue new shares, the company will also have to go through a series of legal procedures, which also have subsequent costs. So in this scenario, it could be advantageous for Sainsbury to use retained earnings to fund its innovation facilities.

Conclusion

The inventory turnover ratio shows how quickly a company reduces its inventory to generate revenue. A higher inventory turnover ratio indicates that a company is financially sound. An extremely low current ratio suggests that the company has significantly more current liabilities than current assets. The company is not able to use its current assets to pay off its current liabilities as quickly as possible. The company's debt to equity ratio is low. In 2019, the ratio of debt to capital structure was 10.49%, the highest in the last four years. Over the last four years, the company's share price has gradually increased.

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