Analysis of Financial Statement

Formal Assignment Report

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Introduction

The purpose of creating this report is entirely involved with the financial analysis based on the financial statements or other relevant sources. To go further with the topic, the report needs a specific company to make progress (McMillan, 2010). The selection of the company had come across a certain criteria which are that the company should not be some financial service provider and it should be listed under FTSE. Now FTSE is share price index and it is the subsidiary group of the London Stock Exchange. The stock indices of it are widely used by the world and also the analytical firms as well (Ohlson, 2000). So the stock indices are particular thing that can measure the high performance of the business according to the regulation of company law of UK. The report should be published in a form that can be helpful for the senior executives of the company. Here in this report the certain financial and operation perspectives of the specifically selected company will be discussed with making the proper analysis (Saunders, 2010). The performed analysis done in this report is strongly based on the calculation of ratios and the reflection that those have to say about the company. As per the description and the regarding on the basis of criteria maintained, the company of Sports Direct International plc is selected as it is assumed that the company is appropriate to investigate further with the report. The following portion of the report will be based on this certain company and part of analysis will be done accordingly.

1. Brief Review

Sports Direct International plc is a group of British retailing industry and the name of the founder of this company is Mike Ashley who situated this company in 1982. The company is a multinational company and it proved to be the largest sporting retailer in the country of UK and it has overall 500 stores worldwide. Sporting goods and equipments are sold by the company (Weygandt, 2009). The large number of sporting brand is covered by the company and also does the business on the basis of sportsdirect.com brand. The speciality of the company is that it operates under the low margin and the company owned some of the other retailers as well as part of its business operations (Yang & Ma, 2013).

The primary aims and focus of the company is to make the highest possible profits and prove themselves as the best sporting company in the world and establish the company's recognition in the global aspect.

The future aim of the company is concentrated on opening 400 more stores in the part of the mainland Europe. So the company is looking for the opportunity to do business in the parts of Europe and keeping the fact on their side to expand globally. The focus of the company is that way can be described as ambitious (Shim, Siegel, Shim & Shim, 2012).

The discussion above can clearly suggest that the company is planning for the expansion in the European market as it is confirmed by the statement of the company's chief executive, David Forsey. Another part of the company's growth strategy consists of closing down their small store across the country and opening larger stores in their place (Saunders, 2010).

The entire planning, growth strategy and the business operation which deals with future aims and objectives of the company is clearly observed as to stay ahead of the other market competitors and remain at the top position where all the competitive advantages can be gained. Also the factor of making stronger investment is the part of the company's future plans (Plummer, 2010).

2. Analysis of Financial Performance

The purpose of this section is to give a close attention to the financial perspective of Sports Direct Plc by computing and comparison of the ratios to its perspective years of operation. Profitability, efficiency and liquidity are fields what are chosen in this analysis for reflecting the effects based on the ratios. A maximum extent of current three years is considered for this purpose (Palmer, 2003). The company is currently operating in its sporting goods sector in UK and come out to be the largest sporting retailer in UK. According to the relevant reports from the sources considering the profile of the company, it is revealed that the company is currently holding the top position in UK in terms of the sporting retailer with the 61.7% holding in the market. In an addition to the sporting sector, Sports Direct has spread its other services in the market as well including the dealings with the fashionable brands for capturing the global market(McMillan, 2010). According to the annual reports published by the company, it is observed that the company is currently giving priority of focus to the non-sporting items and non-UK business. As found in the annual report of the company for the year of 2013, the company's revenue from the sales in non-UK market is £20.8 billion with the hike of 8% revenues from the areas of European market (Fridson & Alvarez, 2002).

So splitting the ratios in the areas of Profitability, Efficiency and Liquidity, the financial standings and performance of Sport Direct can be determined by following with a proper analysis. The reasoning behind the published result of the analysis carried on in this section is entirely supported by the evidence in the annual reports of the company and also other relevant analysis from various reliable sources (Elliott & Elliott, 2006).

Liquidity Ratio

The measurement of liquidity ratio is done on the basis of checking the ability of the company to pay off its short-term obligations. The short term standing of the company is measured by this type of ratios. Here the short-term is focused as the debts that are due for the company and to be paid within one year time duration (Black, 2004). For this concern, the desired result from the ratios are expected to be higher as the more higher the value is, the more the company is capable to pay its debts. As for the examples, the shareholders or the investors will look for the higher value of current assets that the total value of current liabilities as it indicates the fact that the company can repay all its short term debts within a short period of time if necessary (Rao, 2006). But a higher value should not be expected as it suggests that the company is not utilizing its current assets properly during the running of the business.

Current Ratio - Current ratio is one major part of the liquidity ratio as it suggests the capability of the company to repay it short term debts which might be the accounts payables and others with support of current assets such as cash, accounts receivables and inventories. The intension of the ratios is to reflect the company has adequate cash resources or not, or it will face the cash flow problem in near future (Flower & Ebbers, 2002). Depending on the cash flow and types of industries, the result of the current ratio can vary but a desired result of 2:1 is always considered as the benchmark for analysis. On the other hand, the ratio which represent the result less than 1 are considered that the company will not able to pay its short term debts quite sufficiently (Fridson & Alvarez, 2002).

The calculation of current ratios for three different financial years of Sports direct can be showed below.

Current Ratio = Current Assets / Current Liabilities			
Name of the Company	**2011**	**2012**	**2013**
Sports Direct Plc	370/286 0.65	485/338 1.43	708/432 1.64

Quick Ratio–this ratio is a conservative alternative as inventory is removed from current assets. The reason behind this, the inventory is considered that it can be converted into cash very enthusiastically (McMillan, 2010). Giving an example, the company may allow discounts to the customers to finish their inventories fast and generate cash from the activity. So the changing value of the inventories can be often found as it could be lower in amount that the recorded value in the financial statements.

The calculation can be shown below:

Current Ratio = (Current Assets - Inventories) / Current Liabilities			
Name of the Company	**2011**	**2012**	**2013**
Sports Direct Plc	(370 – 218) /286 0.53	(485 – 317) /338 0.50	(708 – 447) /432 0.60

Considering the benchmark the ratios from three years are low. This could be the reason as the trade receivables are lower than the trade payables in order to run the business efficiently (Lewis, 2009). The business has a high level of turnover and from that it can generate cash easily and can be utilized for repayment of debts. On the other hand, the investors or the shareholders will not face a concern about the lower ratios for this kind of multinational business as they will expect a higher value from the other small businesses (Sanzo, 2000).

So considering the aspect it can be said that Sports Direct has an impressive amount of receivables and it is due to the greater focus of the company to the non-sporting items (Plummer, 2010). Also the drawback of the higher receivables can be observed as it may be risky for the company due to the inability of some of the customers regarding the payment of debts.

Capital Structure Ratio

Years	2011	2012	2013
Debt/Equity	0.59	0.45	0.38

Profitability Ratios

The purpose of these ratios is to measure the profitability of the firms where the profits earned by the company are supported to make the payments to the capital expenditures, dividends (Yang & Ma, 2013). So these ratios are too much important to make the analysis.

Earnings per Share (EPS)–this ratio is important for the shareholders as they calculate the earnings available in respect of each share held in the company. They can able to determine the available earning from them if they own shares in the company. The comparison can be made with the dividends to determine about the payout ratio. It is quite important for the shareholders to gather knowledge that the company is using its incomes to sort off the capital expenditures or paying dividends (Weygandt, 2009). If they found that the dividends are low then they expect higher capital expenditure which can maximize the future value of the business along with it increases the share prices and capital gains.

Gross Profit Margin and Net Profit Margin – gross profit margin indicates the deduction of cost of goods sold from the revenues. The efficiency of the production level of company is determined via gross profit margin. The company with the higher amount of gross profit margin from its competitors in the market is known to be more efficient and also preferred (Shim, Siegel, Shim & Shim, 2012).

On the other side, net profit margin indicates the net income of the company once all the related costs are being deducted. The determination of the factors like rising costs or competition can be done with it.

The calculation regarding the above three selected ratios can be shown below:

Earnings per Share = (Net Income - Dividends on Preferred Stock) / Number of Outstanding Shares			
Name of the Company	**2011**	**2012**	**2013**
Sports Direct Plc	84 / 569 0.15	106 / 569 0.19	152 / 569 0.27
Gross Profit Margin = (Revenues - Cost of Goods Sold) / Revenue			
Sports Direct Plc	(1599 – 940) / 1599 0.41	(1836 - 1091) / 1836 0.41	(2186 – 1291)/ 2186 0.41
Net Profit Margin = Net Profit / Revenue			
Sports Direct Plc	84 / 1599 0.05	106 / 1836 0.06	152 / 2186 0.07
Profitability ratio	**2011**	**2012**	**2013**
Return on Assets %	8.97	10.37	11.93
Return on Equity %	28.49	26.45	27.15
Return on Invested Capital %	15.38	18.18	18.79

Return on asset

Return on asset is increasing with the increase in year which signifies that the company is making profit with the increase in fiscal year.

Return on Equity

Return on equity is considered as one of the vital measure of profitability of the company higher value of return on equity proves to be crucial and fruitful for the company. The return on equity is fluctuating which indicate that the company is not efficient in generating income on new investment.

Return on Invested capital

Return on invested capital is increasing in the year 2011 but remain constant in the year 2013 when compared with the year 2012. Increase in the return on invested capital indicates that the company is generating more earning per dollar of capital employed.

According to the calculation, based on the position of the company considering the margin, the company of Sport Direct Plc is enjoying the favourable position that other competitors in the market (Robinson, 2012). The greater margin compared to the market competitors is achieved by the company for giving the preference to the varieties of brand sold by the company for conducting the business and also maintaining the growth. Also the online presence of the company gives it the advantage of lowering the overheads involved in the operation (Plummer, 2010). Considering the latest scenario, the company has taken a charge of £1.2 billion for exciting its US business. This had a favoring impact on the company's profitability margin and EPS.

Efficiency Ratios

The main purpose of these ratios are to indicate the ability of the company on how efficiently it is utilizing its assets as well as liabilities to produce more revenues for the business operation (McMillan, 2010).

Sales to Inventory – sales to inventory ratio is considered in this case to make a clear understanding of the efficiency of the proposed company as compared to the peers of the business.

The calculation can be shown below:

Sales to Inventory = Total Sales / Inventories			
Name of the Company	**2011**	**2012**	**2013**
Sports Direct Plc	1599 / 218 = 7.33 365 / 7.33 50 Days	1836 / 317 = 5.80 365 / 5.80 63 Days	2186 / 447 = 4.90 365 / 4.90 74 Days

The above calculation suggests the ability of the company to turn its inventory on the basis of sales on day basis (Fridson & Alvarez, 2002). The results are not as good as it desired to be and also they are not at a faster pace as well. The reduction to the waste is important for the retailing industries which should be effective in the case of this company. So it is recommended that the company should pay more attention towards its efficiency level as it needs to maintain a faster rate regarding this ratio. The possible reason is that the company's greater exposure to the non-sporting items impacted the levels of stock (Flower & Ebbers, 2002).

Dividend yield

Dividend Yield of the company sports direct is 2.21 % for the current fiscal year. Dividend yield helps to provide a clear and precise idea about the company revenue generation and their required distribution among the different stakeholder. The dividend yield of the company is more than 1. Dividend yield is considered as a measure of investor return.

3. A) Estimation of Value of Stake in the Competitor

The nearest rival or the competitor for the company of Sports Direct Plc is the JJB Sports Plc which is based on the same industry as the selected company is in. the roots of the rival company is also in UK (Elliott & Elliott, 2006). The company also falls under the sports industry of retail business, also same as the company that is selected for the report (Horrigan, 2000). The fate of this company is in the bankrupt situation where the shares are suspended and the administrators are called in. according to the report published in the year of 2012 in October, the part of the business of the company is owned by Sport Direct already (Black, 2004). So the centre of attraction by Sports direct regarding the competitor aspect will always be on acquiring this company and taking control of the entire operation. It is also give the added supplement to the expansion plan of the current company (Morley, 2004). Monitoring on the constantly approaching towards the bankruptcy of JJB Sports, Sports Direct Plc is having the thought of purchasing their shares at a percentage of 10%. So it is needed to be figured out, the value of that 10% stake in the competitor, i.e. JJB Sports Plc. On the basis of that above identified aspect, it is necessary to estimate the value on the basis of proper calculations (Weygandt, 2009).

Stake Holding: the stake holding figure of the company for the given year 2011, 2012 and 2013 clearly signifies that the stakeholder value is increasing with the increase in the year.

Year	**2011**	**2012**	**2013**
Total Stake Holding	36.13	41.7	45.78

According to the records obtained from the sources, Sainsbury is currently having 1932 million shares in issue and the share price is determined to be £2.36.

So if the Sports direct is having the thought of purchasing 10% stake of the mentioned competitor, the valuation of that stake will be,

(10% of 1932million) shares x 2.36 = £4,558.24 million.

The valuation of the stake also changes on the basis of the time period of the holding. The above calculation is estimated on the basis of the current time period, as if Sports direct would purchase the stake at this recent time (Flower & Ebbers, 2002).

3. B) Conclusion & Recommendation

Considering the above analysis of the ratios, it is appeared to be that the company of Sports Direct is in a favorable financial position and the investors will love to invest on the financial areas of the company. Out of the analysis, it is observed that the company is consistently maintaining the high level of margin which is impacted as the greater exposure of the company's decision with the business outside the country and also the significant online presence (Fridson & Alvarez, 2002). The company's success can be evident as it takes the advantage from the economic recovery of the country. The company is also planning to do business outside the grocery market which will also provide it the added benefits comparing to the other competitors in the market. After the analysis, the growth factor for the company is evident and it is reflected in their ways of doing the business operation.

Considering the investment viewpoint, the investor will look for the options of returns, the dividend payout and the dividend growth which can be compared among the three years basis for the company. Analysis on the dividend will suggest that the shares in the company are going down at a 32.41% in the current time period. The company should look into the matter of earning per shares, earning in the form of dividends and the payout ratio as well to improve such situation (Bierman and Smidt,2009).

The extensive offering in both market of UK and internationally has favored a lot to Sports Direct Plc, so it is recommended that the company should look for the various other opportunities to maintain the factor and also to be able to increase it stimulatingly (Wild, et al., 2001).

Based on the discussion, the company is recommended that it should carry on the planning behind the process of extending the business by continuing the European operations and maximizing the availability of different brands (Bradford, 2011). It can able to raise the margin of the company after the overall UK margin was hit since the FY2013 results cause a downfall of 5.2%.

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Appendix:

Ratio Analysis:

Profitability & Investment Ratio	**2013**
Gross margin	40.9
Operating Margin %	9.7
Net Margin %	6.94
Asset Turnover (Average)	1.72
Return on Assets %	11.93
Return on Equity %	27.15
Return on Invested Capital %	18.79

Earnings Per Share GBP	0.24
Dividends GBP	—
Payout Ratio %	—
Shares Mil	621
Book Value Per Share GBP	1.08
Operating Cash Flow GBP Mil	114
Cap Spending GBP Mil	-51
Free Cash Flow GBP Mil	64
Free Cash Flow Per Share GBP	0.1

Working Capital GBP Mil	276
Earnings Per Share GBP	0.24
Dividends GBP	—
Payout Ratio %	—
Shares Mil	621
Book Value Per Share GBP	1.08
Operating Cash Flow GBP Mil	114
Cap Spending GBP Mil	-51
Free Cash Flow GBP Mil	64

Free Cash Flow Per Share GBP	0.1
Working Capital GBP Mil	276
Efficiency Ratio	2013-04
Days Sales Outstanding	7.89
Days Inventory	107.98
Payables Period	46.01
Cash Conversion Cycle	69.86
Receivables Turnover	46.24
Inventory Turnover	3.38

Fixed Assets Turnover	6.78
Asset Turnover	1.72
Liquidity/Financial Health Ratio	2013-04
Current Ratio	1.64
Quick Ratio	0.54
Financial Leverage	2.18
Debt/Equity	0.38
Financial Leverage (Average)	2.18
Interest Coverage	22.49