

Metro Group of Tesco Group

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Course:

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As part of the ongoing diversification plan by XYZ PLC, the insurance company wishes to acquire majority stake, through acquisition, in one of the largest retailers in the world. The board of XYZ PLC has identified either Metro Group the German based retailer or Tesco Group the UK based retailer as a potential target. The strategic ambitions of the company in the acquisition of one of the two leading retailers in the world are to maximize the return on investment and company value of the acquisition.

According to a report by Deloitte (2013) assessing the top 250 global retailers in the world, Wal-Mart Store Inc, a U.S based retailer, was ranked position one in terms of retail revenue, with retail revenue of \$446,950 million. Carrefour S.A., French based retailer came in a distant second with retail revenue of \$ 101,574 million. Metro Group, the U.K based retailer, was the third largest retailer in the world in terms of retail revenue with retail revenue of \$101,574 million. The fourth largest retailer in terms of retail revenue, in 2011, was Metro AG, a Germany based retailer, which posted a retail revenue figure of \$92,905 million. The report continues to state that the results across the top 250 global retailers were a major improvement of the 2011 financial year. It is evident that the retail market despite economic turbulence continues to record robust financial performance.

This report seeks to delve into the financial performance to establish the strengths and weaknesses of the potential targets that is Metro Group and Tesco Group compared to Carrefour, which is almost similar to the two potential targets. The report will take a top down approach, starting with the economic outlook for the retail market in the world and narrow down to the retail market industry by analyzing the two potential target retailers.

Global Economic outlook for Retail Market

On a macroeconomic view of the global economy, Molka (2008) observes that it has been characterized by increased interest rates, volatility in the major global currencies, rising oil prices, housing crisis and diminution of corporate profits, leading to world economies to slide into recession, and thus affecting consumer demand for goods. This has posed serious economic implications on the operating environment for retailers. Deloitte (2013) in their report observes that the retail industry has been operating under harsh economic environment due to the Global Financial Crisis and the recession in the Euro zone region, and as a result stifling growth of the industry. Deloitte (2013) continues to observe that the recession in the Euro zone region, which is the largest economic bloc, has adversely affected the demand for imported goods. Due to shrinking budgets among households, people are spending on basic needs, cutting down on leisure and luxurious goods. This has posed challenges to the growth of the retail industry, particularly in the European Union countries.

Deloitte (2013) observes that retail firms deal with four product-oriented sectors, namely fashion, fast moving consumer goods (FMCG), diversified products and Hardlines and leisure products. Due to tightening of budgets among households all the global top 250 retailers experienced a slow down in Fashion and Hardlines product sectors. Deloitte (2013) reports that the fast moving consumer goods segment outpaced all the other segments to record a revenue growth of 5.6% against a backdrop of economic turbulence. Going into the future and looking at economic regions that Metro Group and Tesco Group have retail branches, analyst expect growth in Western Europe to experience an economic downturn due to the unresolved issue of Euro zone crisis. This will have a huge impact on the financial performance of retailers with operations in

the European countries due to reduced economic activities, therefore hurting household income. The economy of the United States of America is expected to rebound having shown modest improvement, with increased consumer spending. However, the optimistic outlook is hinged on an amicable solution to the fiscal cliff facing the economy. China and other emerging markets are expected to continue experiencing modest growth albeit challenges.

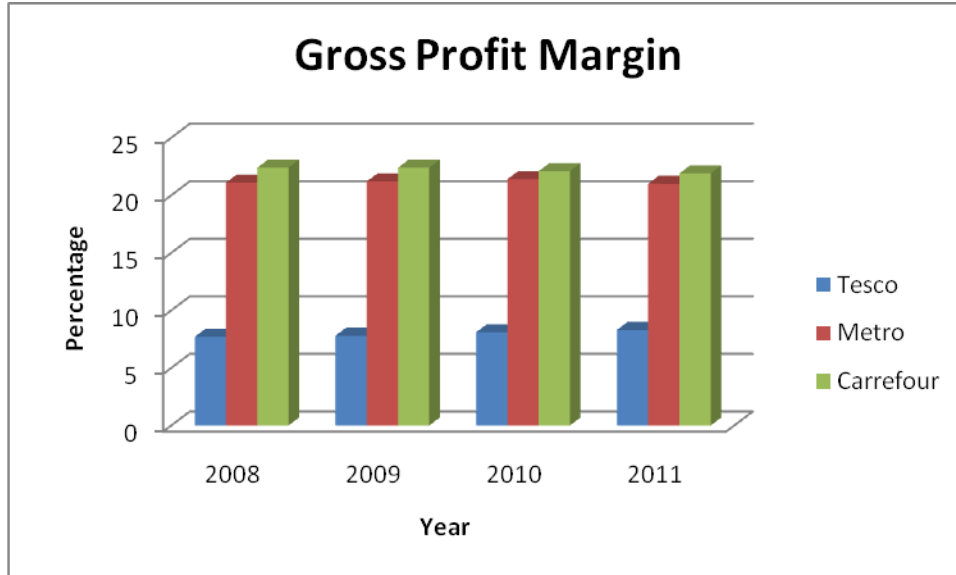
Company Analysis: Financial Performance

This section will look at the financial performance of Tesco Group and Metro Group and compare with the financial performance of Carrefour to evaluate the strengths and weaknesses of the two potential targets. The analysis will be a trend analysis on the last four financial years, financial year 2008 to financial year 2011.

Ratio analysis

Profitability for the three retailers, Tesco group, Metro Group and Carrefour Group, will be measured using gross profit margin, operating margin, return on equity and return on assets. The profitability ratios will be used to measure the ability of the three retailers to generate income in both the short term and long term.

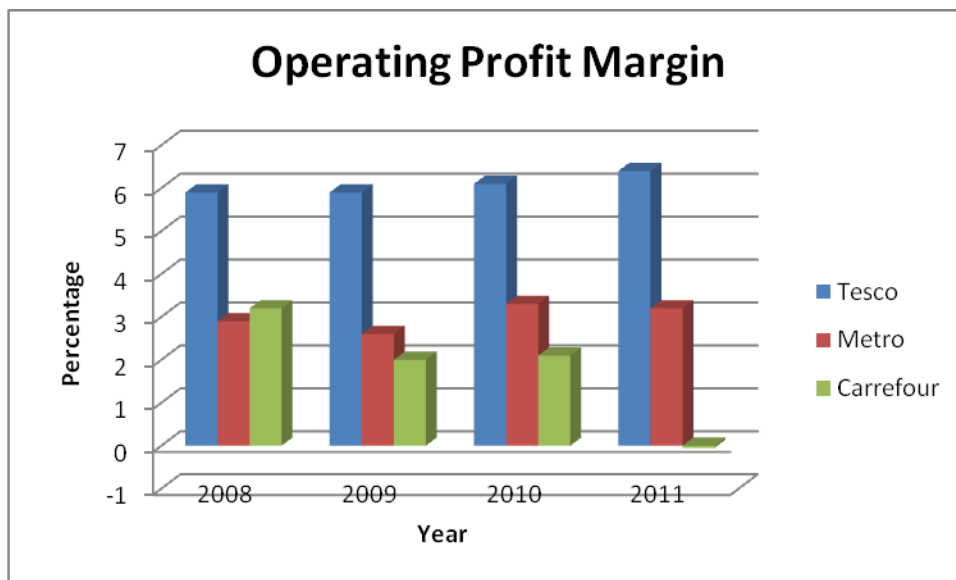
Figure 1. Gross profit margin for Tesco Group, Metro Group and Carrefour Group



In the 2008 financial year, Carrefour Group recorded a gross profit margin of 22.4% aided by a strong gross profit figure of 86,967 million euros. In the same year, Metro Group and Tesco group recorded a gross profit margin of 21.1% and 7.7% respectively. It is evident that the Metro group fared quite well compared to the Tesco Group that recorded a dismal gross margin for that year. Carrefour Group outdid Metro Group by a slight margin. During the following year, 2009. The Carrefour Group recorded a gross marginal figure of 22.4% while the potential targets, Tesco Group and Metro Group recorded a gross profit margin of 5.9% and 21.2%. The only retailer that recorded improvement in 2009 financial year was Metro Group albeit marginal. Gross profit margin for Tesco Group and Carrefour Group remained flat. In the year 2010, Carrefour recorded a gross profit margin of 22.1%, a slight drop from the previous year performance. Tesco Group and Metro Group recorded gross profit margin of 8.1% and 21.4% respectively. Metro Group continued its improvement though slight, improving its gross profit margin by three percentage points. Similarly Tesco Group improved its gross profit margin by three percentage. In this year, gross profit margin for Metro Group was better and stronger than

Tesco's Group, but slightly lower than Carrefours's Group. In 2011, Carrefour Group's gross profit margin was better than the two potential targets, which was 21.9%, though a slight drop of 3% from the previous year's performance. Metro Group and Tesco Group record gross profit margin figures of 21% and 8.3%. From the above parameter, gross profit margin, Metro Group performed better than Tesco Group indicating that Metro Group expenses towards direct generation of sales is lower than Tesco Group's.

Figure 2. Operating profit margin for Tesco Group, Metro Group and Carrefour Group



Financial performance of the two potential targets will be measured against Carrefour Group performance using operating profit margin. In the year 2008 financial year, Carrefour Group recorded an operating profit margin figure of 3.2% while Tesco Group and Metro Group recorded an operating profit margin figure of 5.9% and 2.9% respectively. During this year, it is evident that the Tesco Group was able to record a better operating profit margin performance than the second ranked retailer in the world in terms of retail revenue Carrefour. Between the two potential targets for acquisition by XYZ PLC, Tesco Group was the best performer, having outperformed the benchmark retailer Carrefour and the Metro Group. The following year 2009,

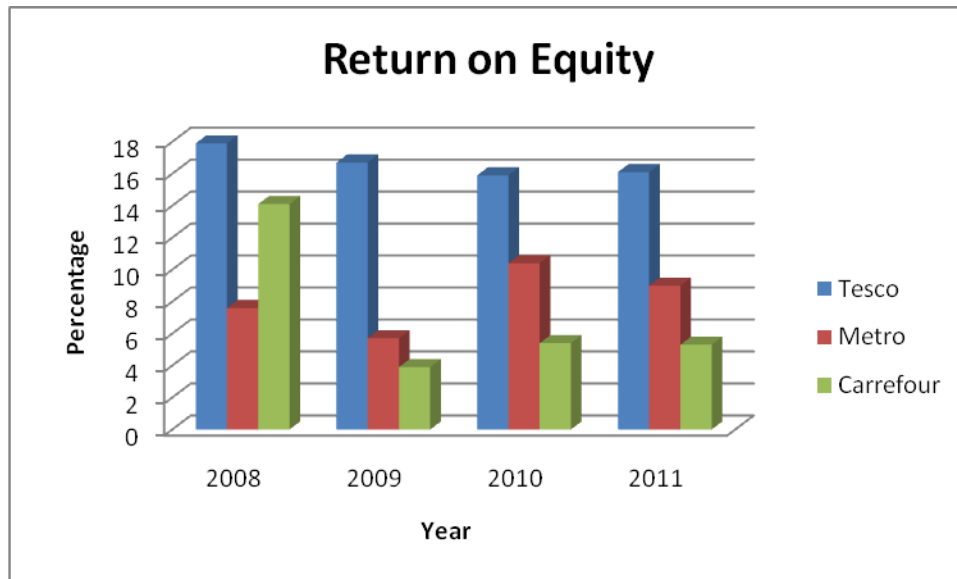
Carrefour Group's operating profit margin went down by 1.2 % to settle at 2%. Tesco Group and Metro Group recorded had their operating profit margin performance set at 5.9% and 2.6%.

Tesco Group's operating profit margin held steady while Metro Group's operating profit margin declined by 1.3%. Between the two potential targets, Tesco Group was the best performer, holding steady its operating profit margin and for the second time in a row performing better than the second ranked retailer in the world in terms of retail revenue. In the year 2010 financial year, Carrefour Group recorded a slight improvement in its operating profit margin recording a figure of 2.1% while Tesco Group and Metro Group recorded 6.1% and 3.3% respectively.

During this year, the Tesco Group recorded a slightly improved performance in its operating profit margin and outperformed the benchmark retailer Carrefour, therefore the Tesco Group was the better performer of the two potential targets set for acquisition. In the year 2011, Carrefour Group recorded a negative performance on its operating profit margin which was set at -0.05%.

This was due to a loss incurred by Carrefour Group of 481 million Euros. The Tesco group recorded an operating profit margin figure of 6.4%, a slight improvement of 0.3% from the previous year. Metro Group recorded 3.2%, a slight drop of 0.1% from the previous year. It is evident that only Tesco Group improved its operating profit margin performance through the four years that is from the financial year 2008 to the financial year 2011. Therefore, between the two potential targets Tesco Group performed well compared to Metro Group, setting Carrefour Group performance as the benchmark performance.

Figure 3. Return on equity for Tesco Group, Metro Group and Carrefour Group



Return on equity will be used to evaluate the profitability of the two potential targets vis-a-viz Carrefour Group. According to Gibson (2010) return on equity measures the profitability of a company against shareholders' equity, which simply is the return that equity holders in a company get from their investment in the company. In the case of the two target retailers we will compare their return on equity against the Carrefour Group's to assess their relative performance in the four financial years. In the 2008 financial year, Carrefour Group recorded a return on equity figure of 14.1% while Tesco Group and Metro Group recorded a return equity performance of 17.9% and 7.6% respectively. Tesco Group, which is a potential target by XYZ PLC, performed better than the benchmark retailer, Carrefour Group, and Metro Group, another potential target. It is evident that shareholders of the Tesco Group received a better return on equity than shareholders of Metro Group. In the year 2009, Carrefour Group recorded a return on equity performance of 3.9%, which was a huge drop from the previous year. This was probably due to the Global Financial Crisis and the recession in Europe. The Tesco Group recorded a return on equity performance of 16.7%, a slight drop of 1.02%. The drop was probably because

of the turbulent economic environment that retailers were operating in given the recession in Europe and financial crisis in the United States of America. Metro Group recorded a return on equity figure of 5.7%, a drop from previous performances. Similar reasons that include is the Eurozone crisis and a slowdown in global economies were probable reasons. In the year 2010, Carrefour Group recorded an improvement in return on equity performance, settling at 5.4%. The Tesco Group recorded a drop in return on equity performance recording 15.9% while Metro Group recorded a huge improvement in return on equity performance recording 10.4%. During this year, Tesco was the best performer in terms of performance based on return on equity despite a slight drop, and Metro the second best performer. This was an impressive performance by the two potential targets because they outperformed the benchmark retailer Carrefour, which is the second largest retailer in the world in terms of retail revenue. In the year 2011, Carrefour Group recorded a slight drop in return on equity to settle at 5.3% while Tesco Group and Metro Group recorded 16.1% and 9% respectively. In the four years in a row the shareholders of the two potential target recorded better performance than shareholders of Carrefour Group. It is evident both on absolute and relative terms that shareholders of the Tesco Group received better returns on their investments than shareholders of Carrefour Group. Between the two potential targets, Tesco Group is the best company to acquire because of its impressive return on equity.

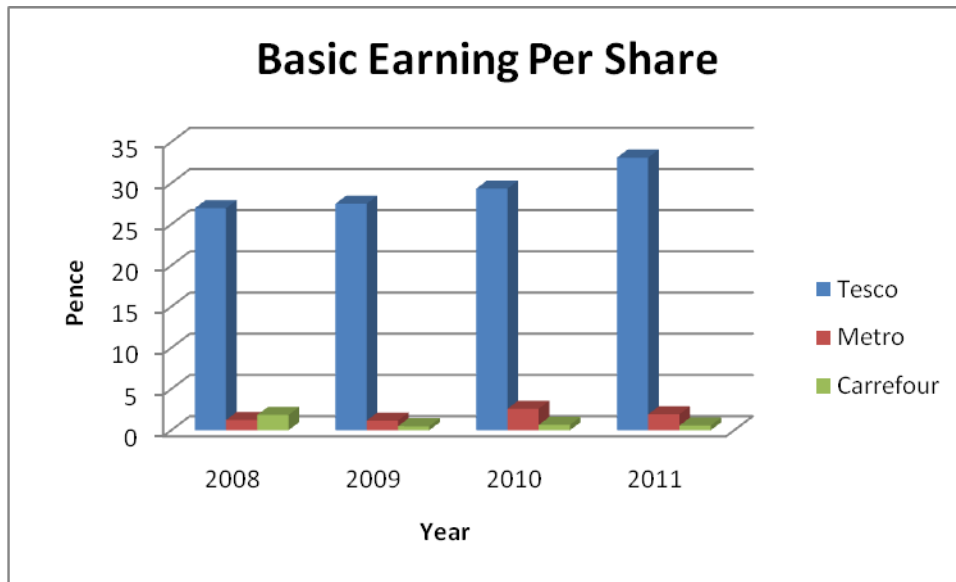
Figure 4. Return on asset for Tesco Group, Metro Group and Carrefour Group



Return on asset is a good measure of profitability and will be used to assess the performance of Tesco Group and Metro Group, two retailers identified by XYZ PLC as potential acquisitions. According to Gibson (2010) return on asset measure the ability of a company to efficiently and effectively utilize its assets to generate income because the higher the efficiency level the better the financial performance of the company. In the year 2008, Carrefour Group recorded a return on an asset figure of 2.9% while Tesco Group and Metro Group recorded 18% and 1.7% respectively on their return asset. The United Kingdom based retailer in generating group's income efficiently utilized its assets than Metro Group and the benchmark retailer, Carrefour Group. In the year 2009, Carrefour Group recorded a drop in its return on asset performance, settling at 0.8%. Tesco Group and Metro Group recorded a return on asset performance of 16.7% and 1.5% respectively, a marginal drop from the previous year performance. The Tesco Group maintained its pole position as the most efficient retailer compared to Metro Group and Carrefour. In the year 2010, Carrefour Group and Metro Group recorded a slight improvement in their return on asset performance to settle at 1.1% and 2.7% respectively. The Tesco Group

recorded a drop in return on asset performance to settle at 16% but remained the most efficient retailer compared to Carrefour Group, the benchmark retailer and Metro Group, which is the other potential target. In the year 2012, Carrefour Group recorded 0.8% as its return on asset while Tesco Group and Metro Group recorded 16.1% and 2.2%. Comparing return on asset for Carrefour Group and the two potential targets Tesco Group and Metro Group, it is evident that the Tesco Group was more efficient than Metro Group, and thus recorded better financial performance.

Figure 5. Basic earnings per share for Tesco Group, Metro Group and Carrefour



Basic earnings per share is an investor ratio that measures the amount that a shareholder gets on each of the share held. The higher the earning per share the more profitable is the investment. In the year 2008, Carrefour Group recorded a basic earnings per share of 1.85 pence while shareholders of Tesco Group and Metro Group were entitled to a basic earnings per share of 26.95 pence and 1.23 pence respectively. Shareholders of Tesco Group earned more on their shares than shareholders of Carrefour Group and Metro Group. In the following year, 2009, shareholders of Carrefour Group were entitled to a lesser basic earning per share compared to the

previous year due to a fall in net income. The shareholders of the French based retailer earned 0.48 pence for each of the shares held. Tesco Group shareholders were entitled to a better basic earning per share than in the previous year, as they earned 27.5 pence compared to 26.95 pence the previous year. Metro Group shareholders were entitled to 1.17 pence on each share held. In the year 2010, Tesco Group shareholders earned better compared to Metro Group shareholders and Carrefour Group shareholders as they earned 29.33 pence while a share of Metro Group and Carrefour Group was entitled to 2.6 pence and 0.64 pence. In the year 2011, Tesco Group continued its impressive performance, with its shareholders earning 33.1 pence while Metro Group and Carrefour Group shareholders earned 1.93 pence and 0.56 pence respectively. It is evident that shareholders of the Tesco Group earned a higher basic earning per share than shareholders of both Metro Group and Carrefour Group.

Conclusion

The retail industry is facing major challenges emanating from the Global Financial Crisis and recession in Europe that is affecting even emerging markets like China and India. The economic crisis is eroding consumer purchasing power and thus most consumers are spending only on necessity. However retail giants are beating these odds to post impressive financial bottom line figures. This report recommends the management to consider acquiring Tesco Group because it recorded better financial performance than Metro Group. The main strength of Tesco Group is that it is efficient in utilizing assets, however its major weakness lies in its direct sales spending structure, causing the U.K based retailer to record a high cost of good sold. Metro Group despite having a lean direct sales spending structure is inefficient in the other operational areas, and thus unattractive investment.

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