Analysis of 2 companies

Domino's

The Pizza Delivery Experts

all about us

List of Illustrations

1 Introduction

1.1 Aims and objectives

We are going to compare and contrast the way in which Domino's Pizza UK & IRL Plc and PizzaExpress PLC discharge their responsibilities of disclosure of information. The disclosure requirements are found in a number of regulatory sources and "guidelines" issued from the accounting bodies and issued codes of conduct and accountability. We can refer to the Financial Reporting Standards (FRSs 1-19) and Statements of Standard Accounting Practice (SSAP). Directors of companies are required by the Companies Act to prepare accounts that give a true and fair view of the state of affairs of the company and of its financial position at the end of the financial year. We are going to identify three main areas to examine both companies' methods, policies and associated disclosures: - Tangible and Intangible Fixed Assets; the Chairman's Report and Cash management.

1.2 The importance of accounting methods, policies and associated disclosures

When we look at the annual report which includes a lot of issues such as Chairman's Statement, Chief Executive's Report, Directors' Report, Auditors' Report, Profit and Loss Account, Balance Sheet, Cash Flows, the last three issues are the accounting figures for the year of the companies. People such as Investors, shareholders would like to concentrate on those figures because it can tell you the capacity, potential of the companies in the quickest way. However, if we only look at the Profit and Loss Account, Balance Sheet, or Cash Flows are not enough for us to understand the whole company because as we know only the figures cannot reflect all the situations and also somehow you would misunderstand the figures because of the different explanation behind. As a result, we should understand more about the general principle of the accounting methods, policies and the associated disclosures. It is very important to understand more of those standards behind the figures because different companies have different accounting policies. They have different accounting policies on accounts.

We can get the information from the annual report, however, what kind of information is important for us? Is it only the main accounts such as Profit and Loss Accounts, Balance Sheet, and Cash flow? The answer of course is 'not only', we should be able to understand all the accounting standards of the financial statements in order to give a prudent way to analysis different companies. We should get the experience from Enron and WorldCom, their pass successes were based on artificially inflated profits, dubious accounting practices, and – some say – fraud which told us we cannot only look at the figures of how much profit they made or how much cash flow in their account, we should also query how they make it.

1.3 Overview of 2 companies: Domino's Pizza UK & IRL plc & PizzaExpress Plc

<u>Domino's Pizza UK & IRL plc</u>
Domino's financial period is every year-ended of December, so the latest Annual Report is December 2000-2001. There are 237 stores in UK & Ireland, the total turnover is 142.2 millions, the retained profit £1.336m for the year-ended. The share price currently is 100p and the EPS in that annual report was 4.00p

PizzaExpress Plc
PizzaExpress's financial period is different from Domino's, it's financial period is every year-ended of June, so the latest Annual Report is June 2001-2002. There are 324 restaurants in the UK and Ireland and 43 overseas currently, the total turnover is £213.7 millions, the retained profit £18.1m for the year-ended and the share price currently is 371p and the EPS is in the report is 35.8p

We are going to look at both companies' latest annual report and mainly discussing on three areas as 'Tangible and Intangible Fixed Assets, Their Chairman's Report, and their cash management.

2 Accounting Principles

2.1 Chairman's Report

Most listed companies usually prepare the Chairman's Report even though companies are not necessary to prepare it. The lay shareholders will read the statement so the statement will widely comment on their trading conditions, general outlook, the main activities of the business, items of special interest such as acquisitions, closures etc., board changes, and the future plans. There is no formal requirement, or audit requirement, however, companies still need to keep the statement in consistency with other issues in the annual report.

2.2 Tangible and Intangible Fixed Assets

According to the FRS 10 (Goodwill and Intangible Assets), 11(Impairment of Fixed Assets and Goodwill), and 15(Tangible Fixed Assets): -
Tangible Fixed Assets must be measured on a consistent basis and the FRS allows either the tangible fixed assets are stated at cost or at revalued amount. The costs of those assets can be capitalized to the extent that they are directly attributable to bringing the asset into the working condition for its intended use, and to get the asset ready for use. The costs should be included acquisition costs, initial delivery and handling costs, installation costs, professional fees etc. FRS15 incorporates many of the requirements of SSAP 12 'Accounting for depreciation'. Depreciation is the measurement of the cost or revalued amount of the economic benefits of the tangible fixed asset that have been consumed during the period.

We have few methods to calculate the depreciations the most popular two are **'Straight Line'** and **'Reducing balance'** methods. There are different requirements for different types of Tangible Fixed Assets, for example investment properties should be revalued annually (SSAP19), others should be followed the company policy of revaluation. Non-specialised properties should be revaluated in full every 5 years, or interim every 3 years, or 1,2 and 4 years if material changes; Specialized properties should update every 5 years and when the material changes. Non property should update the value annually or every 5 years if it's no indicies and also when a material change occurs.

Intangible Fixed Assets are the non-financial fixed assets that have no physical substance involved, and it can be separately identified i.e. they can be sold separately from the business and it can be controlled through the legal rights such as patent, trademarks, copyrights and **goodwill**. In the Research & Development, the original investigation undertaken to gain new scientific or technical knowledge, or use of that knowledge in order to product new or substantially improved material, devices, products, processes, systems or service prior to commencement of production for commercial purpose are also treated as the intangible fixed assets. FRS10 is to ensure that purchased goodwill and intangible assets are charged to the profit and loss account (income statement) in the periods in which they are depleted, and then to be capitalized and to be amortised systematically through the profit and loss account (usually over 20 years or less). Impairment reviews must be undertaken, particular if the goodwill or intangible asset is regarded as having an infinite life and is therefore not being amortised. Internally generated goodwill should not be capitalized and internally developed intangible assets should be capitalised only where they have a readily ascertainable market value. FRS11 is to ensure that fixed assets and goodwill are recorded in the financial statements at no more than their recoverable amount, and they all should be on a consistent bassis. Sufficient information should be disclosed in the financial statements.

2.4 Cash Management

We can refer companies' cash flow statement to measure their ability of cash management. FRS1 requires companies to prepare a cash flow statement which record the increases or decreases in amount in cash, and cash is cash in hand and bank less overdrafts. Cash flow can interpret the changes in liquid fund over two period in the company. An entity's cash flow statement should list its cash flows for the standard items:

- Operating activities
- Returns on investments and serving of finance
- Taxation
- Capital expenditure and financial investment
- Acquisitions and disposals
- Equity dividends paid
- Management of liquid resources
- Financing

We also can compare the current ratio (Current Asset : Current Liabilities) and Quick ration (Current Assets(exclude stock) to Current Liabilities) to analysis the liquidity of the company. Cash flow is one of the factors to be considered by the shareholders or investors.

3 Domino's Pizza UK & IRL plc

3.1 Chairman's Report Summary

Domino's Pizza is a market leader in the pizza-delivery business in UK, they delivered their fresh-baked pizzas to more than one million households. Their goal is to reach more than 2.5 million households by 2006, and planed to have 500 Domino's stores throughout the UK and Ireland. They emphasis to have undergone refurbishment or rebuilt all the Domino's stores every five year so as to maintain the average age of stores was less than two year. Their advertising campaign was successful so they are going to widen the advertising scheme by adding more TV advertisements.

3.2 Tangible and Intangible Fixed Assets policies

Goodwill

Positive goodwill is capitalized and it is classified as an asset on the balance sheet and amortised on a straight line basis over its estimated useful economic life up to 20 year. Any goodwill has not been amortised is taken account in profit or loss on sale or closure.

Regarding for their goodwill, we can find it in P/L's amortisation of (£5,000) for the year, and in B/S the goodwill net book value is £1407 at 31 December 2000, and £1884 at 30 December.

Intangible assets

It is acquired separately and capitalized at cost. It is separate from goodwill if its value can be measured. Intangible assets are not capitalized and expenditure is charged against the profits. It is amostised on a straight line basis over their useful lives: -

Franchise fees	over 20 years
Interest in leases	over the life of the lease

Tangible Assets

Interest incurred on significant property developments is capitalized after completion of the project and also depreciated in accordance with the group's policy.
Depreciation is calculated to write off the cost less residual value over its expected useful life: -

Freehold buildings	over 50 years

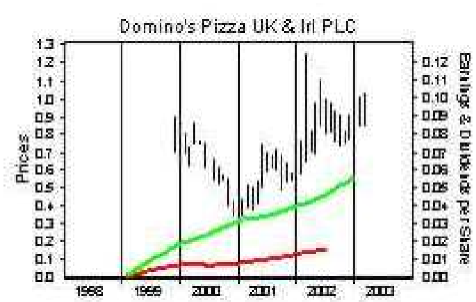
Plant and production equipment	over 10 years
Leasehold building improvements	over the lesser of the life of the lease plus 14 years, or 30 years
Computers, fixtures and fittings and other equipment	over 2-10 years
Motor vehicles	over 3 years
Mopeds	over 18 months

3.3 Company's Cash management & Analysis

A net cash of £4.5m (2000: £2.5m restated) was generated from the operating activities. This strong cash flow was supporting the fully fund capital expenditure of £2.6m and the dividend can have a significant increase.

Included within the financial investments was a net increase of £0.9m in finance lease assets, which arise within a subsidiary company, DP Capital which provides financing to franchisees to assist in the building and refurbishment of stores. The leasing book, which at the year-end stood at £1.6m (2000: £0.8m), is funded by back-to-back bank loans of £1.4m (2000: £0.5m) that have limited recourse to the rest of the group. All such borrowing is reflected in the consolidated balance sheet.

The reserves as 31 December 2000 were reduced by £182,000 because of the adoption of FRS 19, so certain balance sheet values have also been restated and, as a result, at 30 December 2001, the Company had net borrowings of £5.8m (2000: £5.7m) against shareholders funds of £9.6m (2000: £8.4m restated), [1]a capital-gearing ratio of 60.0% (2000: 67.6% restated).



Stock Price (3/14/03): 100.00 p

Stock Price (3/21/03): 99.50 p

Earnings / Dividends (as of 12/29/02) [in Pence]		
	Earnings	**Dividends**
Most Recent Qtr	3.26	0.78
Last 12 Months	6.00	2.00

Ratio Analysis			
Price / Earnings Ratio	16.58	Dividend Yield	2.01%
Price / Sales Ratio	0.95	Payout Ratio	33.33%
Price / Book Ratio	4.83	% Held by Insiders	67.85%

[1] Gearing ratio measures the contribution of long-term lenders to the long-term capital structure, if the level of gearing is high, the company needs to have a stable or growing figure in the business because of the high level of lenders.

4 PizzaExpress Plc

4.1 Chairman's Report Summary

PizzaExpress operates 324 restaurants in UK and Ireland and 43 internationally as at 30 June 2002. The quality of their food, their friendly and efficient service and the décor and atmosphere in the restaurants are the most important priority in the years ahead. They are continue to grow the number of restaurants and new idea of 'Café Pasta' in progress. Sales of their chilled products in Sainsbury's continue to exceed their expectations. They plan to expand their products to other national supermarkets. 'PizzaExpress to Go' which located mass transit locations brings good profit to them. They have several initiatives: -

- Reorganization of their restaurant to reduce costs and to focus on the customer and their needs.
- Improvement in their service standards and restaurant ambience.
- Review of site opportunities
- An examination of acquisitions
- An accelerated capital investment program focusing on the refurbishment of their older restaurants

4.2 Tangible and Intangible Fixed Assets policies

Goodwill
Goodwill shows the difference between the cost of acquisition and the fair value of the separable net assets. Goodwill includes negative goodwill is capitalized and amortised over its useful economic life.

PizzaExpress reported their goodwill differently, they use the negative goodwill in B/L: total goodwill £0.4m at 30 June 2002, £(1.2) at 30 June 2001 because of the Group's investment in the USA was written back during the year. Goodwill acquired of £0.4m relates to the acquisition of Bookcast Trading Limited.

Tangible fixed assets are stated at cost less accumulated depreciation. Depreciation is using a straight-line basis: -
Plant 20%
Furniture, fixtures and fittings 10%
Motor vehicles 25%

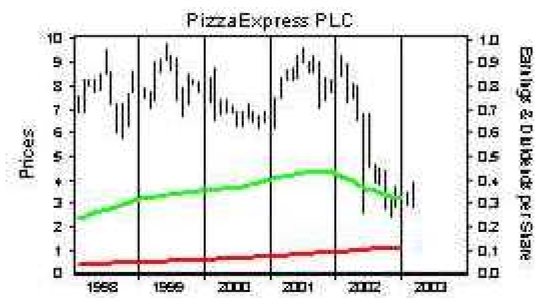
Short leasehold properties are depreciated over the period of the lease except for the anticipated renewal or extension so that an additional 14 years is extendible. The maximum depreciation period is 30 years for that.
No depreciation on assets under construction and the assets for intended use by the group.

4.3 Company's Cash management & Analysis

Cash flow
At a glance of the company's cash flow statement, we could see there was the negative cash flow (£2.6m) substantially lower than in the previous year (£13.1m). This is because of the decreasing of the Net funds at the beginning of the year from £20.5m to £18.0m at the end of the year. And also, share issues generated £1.8m, which is tragically lower than in the previous year (£13.2m). Net interest received in the year was £0.9m (2002) which only higher than previous year £0.5 (2001).

Shareholders' funds and returns, earnings per share and dividends also take effects in the negative case flow: -

The Company had 71.8 million ordinary shares by issuing 0.3 million ordinary shares during the year because of the conversion of deferred convertible non-voting shares, the exercise of share options and the partial bonus payments. Group retained profit for the year was £18.1m and shareholders' funds reduced by £0.1m. As a result of the closing shareholders' funds was £133.3m. Basic earnings per share were down 2% at 37.6p (2001: 38.5p) before exceptional items, and down 8% at 35.8p (2001:38.8p) after exceptional items. There were both increases of 25% of the proposed final dividend is 8p (2001: 6.4p) and the total dividend for the year 10.5p (2001: 8.4p).
The taxation charge is 32.6%(2001:32.3%), which is higher than last year because of the adoption of FRS19 and the reversal of tax deductions relating to outstanding share options.



Stock Price (3/14/03): 371.00 p
Stock Price (3/21/03): 381.00 p

Earnings / Dividends (as of 12/31/02) [in Pence]

	Earnings	**Dividends**
Most Recent Qtr	16.60	3.00
Last 12 Months	32.00	11.00

Ratio Analysis

Price / Earnings Ratio	11.59	Dividend Yield	2.96%
Price / Sales Ratio	1.25	Payout Ratio	34.38%
Price / Book Ratio	1.87	% Held by Insiders	0.74%

5 Conclusion

5.1 Domino's & PizzaExpress differences and commons

Overall the 3 areas (Chairman's Report, Fixed Assets, and Cash Flow) compared, basically, they are not far different for the interpreting of their accounting statements, they all have similar method, for example, the calculation of their depreciations (both use straight line method), the layout of their accounts, their accounting policies etc. For the differences of two companies, although both companies (Domino's Pizza & PizzaExpress) are running the franchise, the former sells the franchise as part of their intangible assets, but the latter does not sell it.

5.2 The summary to conclude both companies' performance by figures: -

Both Turnover, profit, EPS and Dividend comparison

Domino's Pizza UK & IRL plc	PizzaExpress Plc
Group turnover up 35% to £43.8m (2000 : £32.5m)	Group turnover up 15% from £185.6m to £213.7m
Pre-tax profit up 31% to £2.9m (2000: £2.2m)	Profit before tax, exceptionals and losses on discontinued operations down by 0.5% from £39.9m to £39.7m
Earnings per share: Basis earnings per share up 53.3% to 4.0p (2000: 2.61p) Fully diluted earnings per share up 53.4% to 3.88p (2000: 2.53p)	Pre-exceptionals basic EPS down 2% to 37.6p Post-exceptionals basic EPS down 8% to 35.8p
Total dividend up 66.3% to 1.33p per share (2000: 0.80 per share)	Proposed final dividend up 25% from 6.4p to 8p

Key Ratio Analysis for Domino's Pizza & PizzaExpress Plc

	Domino's Pizza	PizzaExpress Plc
Market capitalisation (£ Milions)	49.61	272.75
Normalised P/E	25.17	10.24
P/E excluding extraordinary items	25.21	10.64
Return on average common equity (%)	22.29	20.76
Return on investment (%)	12.28	18.69
Profit margin (%)	4.57	11.98
Gross margin (%)	47.22	26.81
Operation margin (%)	7.33	17.88
Annual dividend per share (£ British Pounds)	0.01	0.11
Current ratio	1.27	0.97

As a conclusion, we may say Domino's Pizza has more potential to be invested, although their capital may not be as much as PizzaExpress, their increasing profits, sufficient cash flows, and relative ratios can show us Domino's Pizza is in a healthy position.

6.1 Recommendations

6.2 For Domino's Pizza Report

Both companies are in the food sector and their objectives are mostly the same as their Chairman mentioned. They mentioned to expand their numbers of stores/restaurants, maintain high standard of their food & service. However, we should highlight the refurbishment for Domino because as we know Domino is a pizza delivery store, the mode of their business is to deliver the pizza. The stores throughout the world are for delivery pizza. However, the proposal for keeping the age of their store less than 2 years and rebuild the store seems not really practical. They should try to concern about their delivery facilities such as the delivery van,

6.3 For PizzaExpress's Report

We may suggest that they should put more attention to promote through the advertisements, or sponsorships in order to increase their market shares. On the other hand, they have negative cash flow at 2002, so they may consider issuing more share capital and debentures to help their shortage of cash flow.

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For the update EPS/Dividend charts: -
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For the Enron and WorldCom Scandals' comment
Analysis by Prem Sikka, Professor of accounting, University of Essex

For the summary of FRS
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