FRIDAY 11TH OCTOBER // ISSUE NUMBER #03

THE WEEKLY 5

HERE IS OUR WEEKLY NEWSLETTER ROUNDING UP THE KEY STORIES, FACTS AND FIGURES FROM THE WORLD OF BUSINESS AND ECONOMICS.

The 54-year old company famous for its traditional meals and stylish restaurant design is running out of time to correct its own debt problems.

Pizza Express' Crusty Results

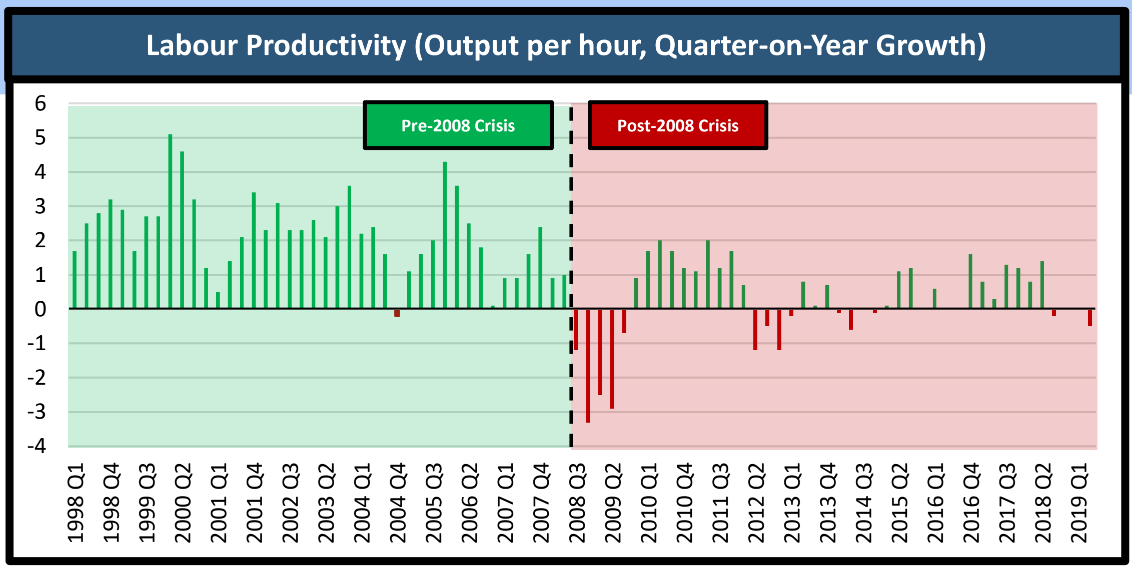
PIZZA EXPRESS HAS HIRED A SET OF FINANCIAL AVISORS TO MANAGE THE COMPANY'S GROWING DEBT PROBLEMS AMIDST A WEAKENING TRADING ENVIRONMENT.

Founded in 1965, by a seasoned traveler and London-based journalist, Pizza Express has always prided itself on delivering an authentic continental dining experience to the casual dining sector of the UK. The chain is now a household favourite not just with millions based in the UK but across hundreds of different cities in the world. This is reflected by the fact that international markets produce 20% of the restaurant chain's total sales.

Many accredit the success of Pizza Express to its delicious combination of its traditionally seasoned menu and its stylish presentation style. The brand awareness of Pizza Express exploded in the 1990s and this culminated in the firm going public and presenting local budding entrepreneurs the opportunity to buy into a Pizza Express franchise. Throughout the course of time, the restaurant chain has changed hands a fair few numbers of time after the founder of the business sold his shares in the 1990s.

However, if you look beyond the stylish visage of the 480-store company, something more troubling lurks beneath the surface. The chain like many in the casual dining sector has experienced troubling financial results. In 2018, the company recorded a £55m pre-tax loss which reflected not just truncated consumer sentiment, but also an over ambitious expansion plan by the chain.

The pizza chain is defined as "highly geared" which just means it is extremely reliant upon borrowed funds to finance its business model. The firm's debt pile stands at a whopping £1.1bn and £660m of that debt is due to be repaid by the year 2021. The need to wrestle back control of this company debt crisis means that each year it is faced with a huge interest rate charge (£93m a year). In the last two years it is this net interest bill which has contributed to the firm declaring a loss rather a profit. The firm has appointed a set of seasoned financial advisors to review the company's debt position and cook up a strategic plan to manage this looming problem by 2021.



UK Productivity (Output per hour) has fallen to its lowest level since 2013 after a 0.5% fall in the productive output of UK workers in the second quarter of 2019.

UK's Alarming Productivity Slump

FEARS OVER THE PROPSECTS AND PERFORMANCE OF THE UK ECONOMY HEIGHTENED THIS WEEK AFTER A DROP-OFF IN UK PRODUCTIVITY.

Productivity is a concept that is used to describe how we can maximise as much out of what we do with the time and resources we have at our disposal. Individuals wish to be as productive as they can be to maximise their personal and professional wellbeing. Companies wish to raise their productivity prospects to reduce average costs and boost profitability. Governments wish to raise productivity to ensure that living standards across the country continues to rise (higher GDP from the same resources).

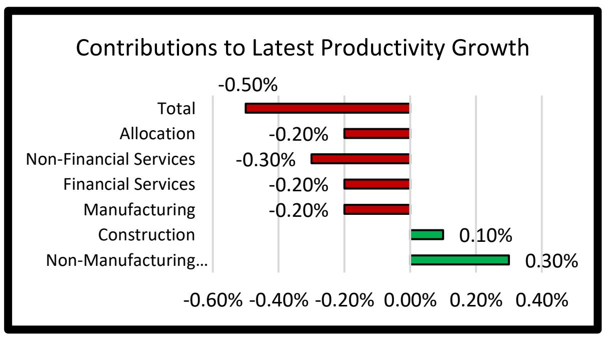
Whether it is at a company level or wider national economy level, the broadest measure of productivity is the amount of output that is produced per worker per given time period. The interpretation is simple. If this measure is rising then the workforce is becoming more productive (more output from same inputs), but if it is falling this reflects reduced productivity.

This matters greatly to companies across the country because the option of expanding to increase output is not a financially sustainable business approach. An approach where the business scrutinises what it does and identifies how it can source productivity improvements is a more sustainable and cost-effective approach.

Higher business productivity across the economy results in higher living standards. More productive workers are rewarded with higher wages and lower average costs is reflected in lower prices for consumers.

The Office for National Statistics (ONS) this week released the latest quarterly growth figures for the UK economy and it did not make pretty reading. During the second quarter (April to June) of 2019, UK output per hour (GDP divided by the number of hours worked) fell by 0.5% compared to the second quarter of 2018. On the face of it, this does not seem such a dramatic statistic, but if we consider the wider trend that this figure belongs to, it points to a number of longstanding productivity weaknesses such as cheap labour replacing investment, relatively low R&D expenditure and poor management practices.

There has been a chronic period of weak productivity growth since the 2008 financial crisis (see chart above). Yes the number of quarters in which UK productivity has contracted is only 14, but the average growth rate in productivity has fallen even in the positive quarters compared to pre-crisis period. This reflects the concerns over the UK's productivity problem and the impact this is likely to have on real wages going forward.



Tech Tax Changes

The Organisation for Economic Co-operation and Development (OECD) published a new tax proposal this week to grant countries greater power to impose new tax legislation on large tech-based companies.

For years, the small business community, individual governments and multilateral organisations have drawn attention to the suspected rise in large multinational corporations (MNCs) failing to pay their fair share of tax relative to the profit that they turn over.

Corporation tax is the specific form of tax that governments impose on a company's bottom line profitability. This tax is meant to reflect the two-way relationship between a company and a country that it sells/produces in. The company uses the country's resources and market potential to generate revenue, turn over a profit and increase its global brand presence. The government in return receives a cut of those profits to fund their own development plans through their own individual corporation tax rate.

Many large tech driven MNCs have complex corporate structures, in which a large share of goods and services are sold without the need for a physical base. Now you might say that this reflects the impact of globalisation, but it has obfuscated the tax boundaries that companies must adhere to. For example, in August 2018, the giant American retailer Amazon announced a record quarterly profit of $2.5bn, in the UK it's recorded pre-tax profits over this same period tripled to £72m. However, if we were just to look at the corporate tax figures alone, the firm reduced its corporate tax bill by 50% to £4.5m.

Now you do not need to be an accounting whizz to figure out that something here is a little bit mis-placed. How could Amazon seemingly report these two contrasting figures on their accounts and still have fully adheredto the local tax regime standards of the UK?

TECH GIANTS: Under new proposals large tech firms such as Facebook may have to pay a new and much larger tax to reflect growing profits.

Well MNCs are in a unique position where they can manage several local companies in a whole host of different countries. Some of those companies are set up for tax purposes and tax purposes only. Amazon's UK retail sales are channeled through to a separate company set-up in Luxembourg (which has a lower corporation tax rate than the UK). The company has been pooling together all of its sales made across Europe and declaring its headline sales profit figures in its European headquarters in Luxembourg.

This technically legal but unethical behavior has motivated countries into improving the global standards of the corporate tax system to recover lost tax revenue. This week, the OECD (a multilateral intergovernmental organisation of 36 countries) released a proposal promising a global overhaul in the tax system. This would provide individual countries with the collective bargaining power to adapt to digitally driven firms. The proposal states that it will arm countries with the appropriate powers to tax companies based on the origins of sales rather than focus on just profits. The OECD has committed to the release of specific policy plans by 2020 and discouraged any unilateral country from forcing through its own individual tax policy in the meantime.

The Week by Numbers

HERE IS A SUMMARY OF SOME OF THE BIGGEST STORIES OF THE WEEK BY NUMBERS

2,500 — Thomas Cook Group

The number of jobs which Hays Travel plan to save after their takeover of 555 expired Thomas Cook travel agent stores. The existing stores will be branded under the new Hays Travel name.

28

The number of Chinese tech companies that have been banned from buying goods produced by the United States over a human rights row and the escalating trade tensions between the US and China.

25% — London Stock Exchange Group

The drop in the number of firms listing their shares on global stock markets (IPOs) in the third quarter of 2019 compared to 2018.

$6.4bn — SAMSUNG

The declared third quarter operating profit of Samsung Electronics. This represents a 56% fall on last year's quarter as the firm has reported four consecutive falling quarters of profit due to falling memory chip prices.

2020 — SONY

The release year for the PlayStation 5, Sony's new next generation video games console. This will launch alongside a new Xbox console around the festive period of 2020.

Lidl's Growth Spurts

THE UK'S SEVENTH LARGEST GROCERY RETAILER SHOWS NO SIGNS OF SLOWING DOWN AFTER A LEAKED PLAN TO LAUNCH AN ONLINE DELIVERY SERVICE

In 1994, the relatively unknown German supermarket chain Lidl launched its first store in the UK. This move was perceived by some as a move destined to fail. This is because the UK supermarket industry had been dominated by the same collection of incumbent firms for too long. However, the chain's simplified product range and low-cost business model has slowly enabled the chain to gobble up some of the profits that the traditional Big Four (Tesco, Asda, Sainsbury's and Morrison's) firms have left behind after weakening trading conditions. Customers value the consistent pricing strategy on own-branded goods compared to the short-lived promotions and price cuts that are regularly handed out by the traditional firms in the market. The company now employs 22,000 people and currently has 760 UK based stores.

The firm has a market share of 5.8% and that is a very commendable figure given the firm only operates on a physical basis and does not offer an online shopping platform. The firm has a history of aggressively targeting its strategy and after news this week leaked regarding the firm's blueprint plans to launch an online delivery service to compete with other firms in the market, this will help support the firm in its ambition to continue to push sales and market share ever higher.

THE WEEKLY 5

The Downfall of Thomas Cook

ON SEPTEMBER THE 23RD THE BRITISH BASED TRAVEL GROUP THOMAS COOK WENT INTO LIQUIDATION. HERE WE DETAIL THE DEMISE OF THE TRAVEL CHAIN AND THE DISRUPTION THAT THIS HAS CAUSED.

In 1841, a local businessman in a sleepy old town in Leicestershire called Thomas Cook set up a company that helped organise railway journeys for passengers in the local area. Over time, with better transportation and communication networks the business evolved to operating as a national travel operator with the same purpose of connecting travelers with the most appropriate travel services. The company traded under the name Thomas Cook & Son to reflect the family roots of the business.

The growth of the company reflected wider social and economic progression in the UK. Long excursion trips abroad were no longer exclusive to the rich and famous. As the leisure travel market grew, so did the firms that operated within it.

In 2007, the Thomas Cook Group was formed as a result of the merger of two separate businesses, Thomas Cook & Son and MyTravel Group. This provided the newly formed group with the capacity to provide both airline services and to operate as a travel agent. This equated to annual efficiency savings of £75m.

Thomas Cook began to position itself specifically in the market segment of package holidays with the convenient service offering of presenting customers with the opportunity to book all aspects of their holiday experience under one brand name. The brand loyalty associated with Thomas Cook grew as a result and the firm relied on the continued loyalty of their customer base to drive through business rather than through the certain ownership of assets such as planes and all-inclusive hotels.

This strategic maneuver was a dangerous one as it placed the fate of the business model in the hands of customers and market sentiment. The 2008 financial crisis changed the way individuals approached booking their holidays and many of the packaged deals offered by Thomas Cook were being shunned for fast and cheap alternatives provided by low-cost airline specialists such as EasyJet. Customers were beginning to sacrifice the convenience of one firm managing their holidays by taking up the most affordable flights deals available.
The concept of the package holiday was crumbling, and Thomas cook was beginning to feel the heat.

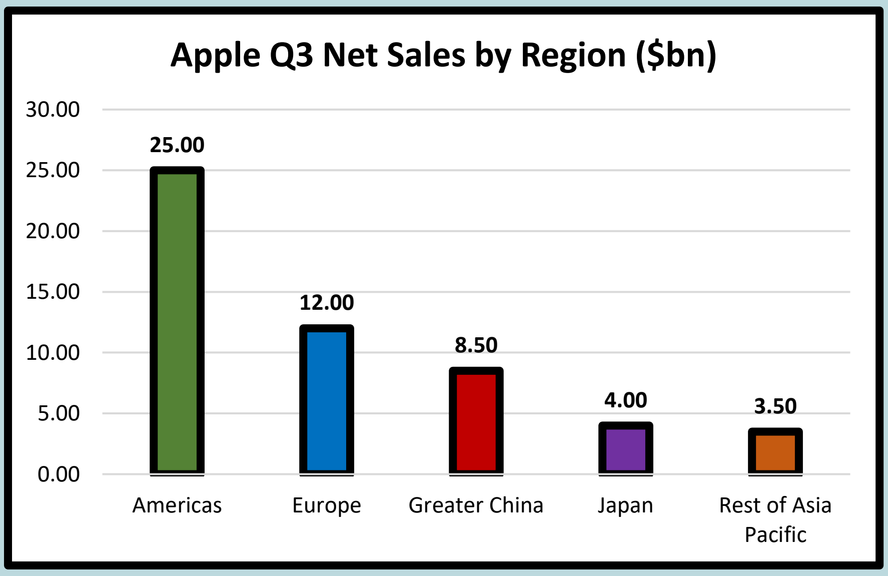
The firm announced a half-year loss of £1.5bn in 2019 due to many of the travel group's assets being written off to reflect the loss of goodwill from customers in the business. Shareholders were edgy and pessimistic, and the travel group did little to reassure those shareholders with a credible recovery plan wrapped up in a string of profit warnings. The response was brutal, and the share price collapsed dramatically, resulting in the company's shares being defined as "worthless" when considering the company's debt position.

Internal financial troubles combined with external difficulties from the fall in the value of the pound (fuel is paid for in dollars) and customers shunning foreign holidays for domestic ones, meant the company required emergency funding from creditors quickly.

There were rumours of a rescue takeover deal coming to pass, but all hope for the travel firm was lost when the prospective buyers demanded an extra £200m proof of funding to provide insurance the business could sustain its current business model. The company was unable to secure the cash required for the takeover to go through and the firm collapsed with 160,000 British tourists left stranded without an airline to fly back home on from their holidays.

The Government and the UK Civil Aviation Authority (CAA) announced that the tour operator had ceased trading with immediate effect and used its pool of funds to help run flight services to stranded British tourists. The funds required for this repatriation service have been built up through industry travel levy's over time.

From the business standpoint, the collapse of the travel group put 9,000 jobs in the UK at risk, with a further 13,000 abroad put at risk from the collapse in the travel group. The group's exposure to the high street with travel agent stores has seen yet more bad news for those that prefer to use the high street as an alternative for shopping compared to clinical online services.



DATA: Chart that shows the regional breakdown of business that Apple has recorded in the third quarter of 2019.

CHART OF THE WEEK

The global tech giant's concentrated focus on revenues from the iPhone is normally put in the spotlight by industry commentators and journalists, but the regional breakdown of the company's large revenue streams is not as prominently reported on.

For Apple, the ability to wrestle into the Chinese market is hampered by the level of local state intervention into its devices and services. The region has tough censorship laws that prevent many of Apple's popular services from being fully accessible. This is why many cheaper Chinese alternative products to Apple have thrived in the region.

This chart however shows that despite the relative muted success of Apple in the Chinese market, almost a fifth of the company's revenues in the third quarter stemmed from this region (27% of profits as well). This chart encapsulates the global reach of large multinationals such as Apple and how difficult a balancing act it can be satisfy the local needs of different markets, whilst maintaining a consistent brand image and company values.

Dyson Scrap Electric Car Project

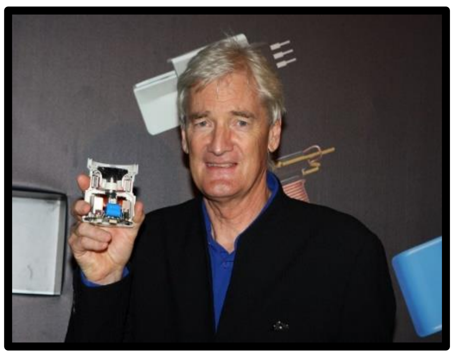
DYSON, THE UK-BASED COMPANY BEST KNOWN FOR ITS VACUUM CLEANERS, HAS SCRAPPED A £2.5BN PROJECT TO BUILD A RANGE OF ELECTRIC CARS.

The firm, headed by one of the UK's most renowned entrepreneurs Sir James Dyson, announced on Thursday this week the company had taken the tough decision to scrap a previously planned project to invest in developing an electric car model for release in 2021.

The electric vehicle market is projected to grow to almost $600bn by the year 2025, with many consumers considering energy efficient alternatives to traditional petrol or diesel engine cars. However, many consumers are initially put off by the premium prices of the electric models currently on offer, as well as the lack of charging infrastructure in place.

Despite, Dyson's expertise in the field of releasing ground-breaking products to the market, the challenge of producing an electric car to the right standard at the right price to challenge market specialists was too much of an ask. Dyson stated that the company had struggled to identify how they can turn this ground-breaking project into one that was "commercially viable" and this perhaps explains why the company was unable to attract a buyer that would continue to fund this project even with Sir James Dyson at the helm.

This is a classic example of a business having to react and make strategic changes to their business plans based on the financial reality of managing projects. The firm has already committed to £200m in R&D costs and site development for the project, but the firm has suggested that the outcomes of this investment will be used for future ground-breaking projects.



Sir James Dyson: The man behind some of the UK's most innovative domestic appliances has cancelled his company's flagship electric cars project.

BUSINESS CONCEPT OF THE WEEK

Gearing Ratio

THE GEARING RATIO IS ONE OF THE MAIN FINANCIAL RATIOS USED BY A BUSINESS TO ASSESS THE OVERALL HEALTH OF A BUSINESS AT ANY GIVEN POINT IN TIME. IT TAKES SPECIFICALLY FOCUSES ON THE CAPITAL COMPOSITION OF THE BUSINESS AND HOW RELIANT IT IS ON BORROWED FUNDS.

To be able to understand the concept of the gearing ratio and why it is so important you need to be comfortable with the difference between raising funds through raising funds through shareholders (equity) or borrowing funds from external sources (debt). The terms at which a business needs to repay their shareholders/creditors is the basics of what the gearing ratio attempts to measure.

A company can issue equity to shareholders by selling shares, and in return, shareholders inject a fixed amount of money into the business to prop up the company's financial accounts. The business is committed to rewarding shareholders with a future slice of profits via dividend payments, but there is flexibility over the value of dividends that must be paid out as it is dependent on company profitability. Therefore, raising money by raising funds from shareholders provides a more flexible funding approach for a business as there is no obligation to pay a fixed amount at a specific period i.e. in the case of an economic downturn the company may cut the value of dividends that they pay out to shareholders to protect the business financially.

On the other hand, raising funds by borrowing results in the business having to meet a pre-determined repayment schedule with an interest rate bill attached on top it. There is no flexibility for the business in meeting these repayments. If the business' performance deteriorates, the money to meet the repayments and interest bills still need to be met.

Gearing Ratio

$$\frac{Non-Current\ Liabilities}{Capital\ Employed} \times 100$$

The gearing ratio considers the proportion of a business's long-term funding (non-current liabilities) that is raised through borrowing relative to shareholder funding (capital employed). It is expressed as a percentage and is interpreted on the basis of the level of risk that is associated on a company's balance sheet (statement of financial position).

A high gearing ratio indicates that the firm is heavily reliant upon borrowed funds and may run into problems along the way. We call any firm that has a gearing ratio above 50% as a highly geared firm. A low gearing ratio indicates that the firm is sufficiently positioned to manage its repayment schedules effectively.

Those firms that find themselves in a highly geared position need to find ways of reducing their exposure to borrowed funds over the next fundraising cycle. This could be achieved by holding onto more profits that have been turned over in the past or making a commitment to focus on more equity funding rather than debt funding.

Enjoyed what you have read so far? Why not challenge yourself with a few teaser questions based on the material found in this week's edition of the Weekly 5.

Calculate the percentage of Apple's Q3 Net Sales from the Americas region. Round your answer to 1 decimal place.

Explain three approaches that can be used by a "highly geared" company to reduce its gearing ratio.

Investigate and research the link between a country's corporation tax rate and the economic growth rate of that country.

To what extent do you agree with the view that a firm can use digital technology to increase its market share?

Why is it important for managers to clearly communicate change within a business to stakeholders when implementing a new strategy?