Executive summary

The objective of this report is to present financial performance analysis of Wal-Mart Stores Inc for financial years (FY) 2010 and 2011. The analysis is carried out by employing ratios as analytical tools to assess the company's liquidity, working capital management, capital gearing, cash flow management, profitability, and investment ratios performance. Moreover, the analysis is not only intra-company, but inter-company as well, thus provides more meaningful insight into the company's financial performance. Wal-Mart's liquidity is satisfactory; however, compared to the industry average, it seems insufficient. Their working capital management analysis highlights phenomenal performance which strengthens their position to meet current obligations, and in turn helps them sustain their A-1 short-term credit rating. Wal-Mart's gearing analysis makes it evident that its capital structure is financially leveraged by having 60% of debt financing. However, their financial risk is minimised by showing an exceptional interest coverage, which makes it a more attractive option for creditors. Their cost of borrowing being less than the return on investment makes financial leverage favourable for them, and enables them to sustain AA credit rating. The favourable effect of financial leverage is also reflected in their ROCE of 9.18%; much higher than the industry average of 6.7% in FY2011. However, it would be conservative to conclude that the ROCE is only driven by financial leverage because their phenomenal asset turnover of 2.36 times also plays a pivotal role in driving ROCE higher. But, unlike returns, margins for Wal-Mart are not as satisfactory; the effect of which is also evident in their poor operational cash flow generation. Therefore, it is advisable that it should implement expense control measures so that increase in its revenue could be reflected in its profits. Nevertheless, higher profitability than its competitors enables it to provide a consistent stream of dividends to its shareholders, which shows a corresponding increase in demand for its stock in the market; consequently, surging its stock price. The last section of the report highlights various sources of finance employed by the company during FY2011. Wal-Mart's 70% retention ratio, 60% of debt financing and 38% of common share financing substantiates that its management prefers internal sources of finance to external and debt financing to equity financing. In a nutshell, Wal-Mart's performance and capital structure analyses help conclude that its management is effectively and efficiently utilising the available resources to keep its financiers satisfied.

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Introduction

The objective of this report is to present a comprehensive financial performance analysis of Wal-Mart during FY ended Dec 2010 and 2011. The analysis is carried out by employing ratios, which help assess the company's liquidity, working capital management, capital gearing, cash flow management, profitability, and investment ratios performance. To make this analysis more meaningful, not only intra-company, but inter-company performance has been assessed as well. The report also presents an analysis of Wal-Mart's sources of finance to help assess the associated risk.

I. Company Profile: Wal-Mart Stores Inc.

Wal-Mart Stores Inc, popularly known as Wal-Mart, has been operating in the retail segment since 1969. The company has three separate strategic business units, namely, Wal-Mart US, Wal-Mart International, and Sam's club (WMT, A: 2011).

Segmental reporting analysis of the company helps identify that 62.1% of its total revenue is derived from Wal-Mart US, which includes sales from retail stores in the USA and Puerto Rico, as well as their online store. The second segment, Wal-Mart International, which generated 26.1% of total revenue in FY2011, include sales at various international retail stores and Sam Club in the international region. Sam's club is cost-efficient warehouse for small businesses; started in 1983, and today is operational at 611 locations in the US and 100 internationally. It provides 11.8% of the total revenue for the company.

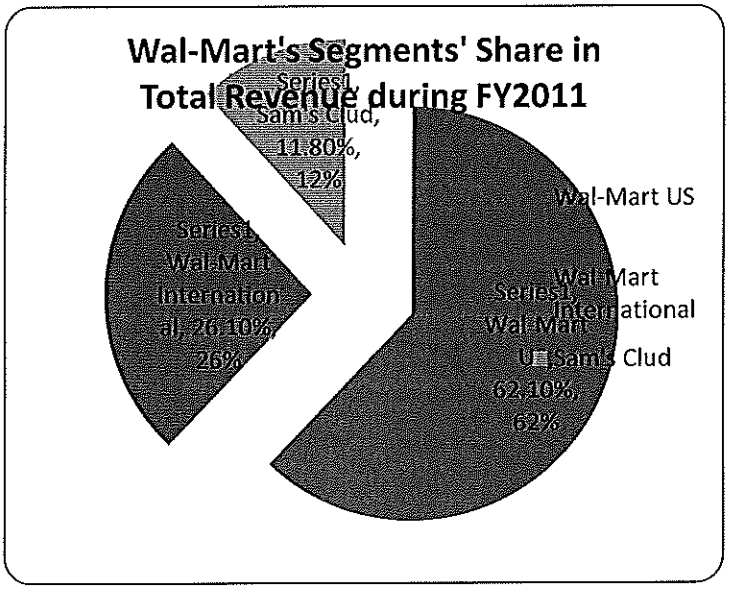


Chart 1

Wal-Mart went public in 1972 and now owns 4,400 retail facilities in the USA and 5200 in over 27 countries worldwide. It employs 2.1m people who provide services to over 200m customer per week (Walmartstores.com, 2012). Its product portfolio consists of grocery items, health and beauty, household goods, movies/books, electronic items, and pharmacy. It

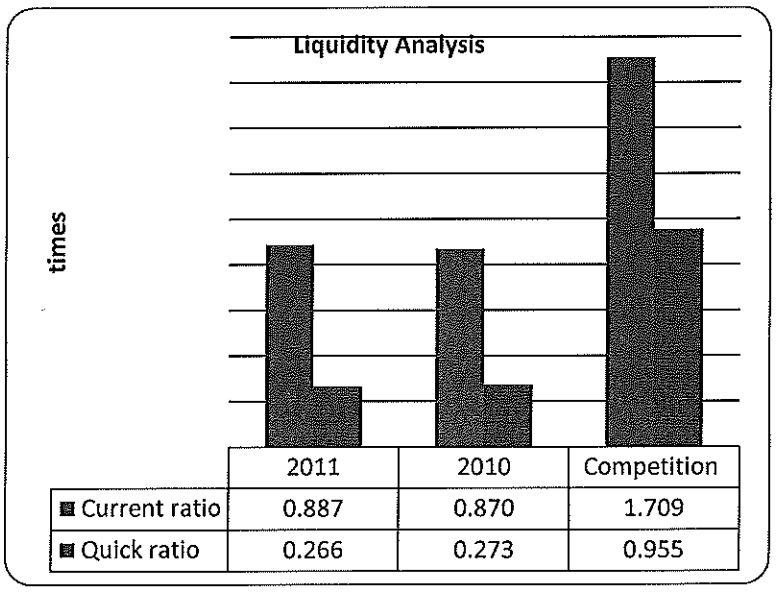
also offers financial services like bill payment, wire transfer, and making money orders (Walmartstores.com, 2012).

II. Financial Ratios Analysis

For readers' convenience, pictorial presentation of each ratio is incorporated into the analysis; the mathematical calculation carried out is presented in the Appendix to the report.

(i). Liquidity analysis

It helps indicate the ability of a company to meet its short-term obligations in a timely manner (Brigham & Houston, 2010). Current and quick ratios are employed to assess a company's liquidity.



	2011	2010	Competition
Current ratio	0.887	0.870	1.709
Quick ratio	0.266	0.273	0.955

Chart 2

(a) Current ratio

It indicates the ability of a company's current assets to get converted into cash quickly so that current liabilities can be paid off (Brigham & Houston, 2010). Wal-Mart's current ratio was 0.87:1 in FY2010, which increased by 2% to become 0.88:1; it implies that it has 87 cents to repay $1 of current liabilities. The decrease in current ratio could be attributed to 7% increase in current assets, when its current liabilities increased by 5% only. The increase in current assets was driven by 23% increase in receivables and 10% increase in inventories; whereas increase in current liabilities was driven by 22% increase in current portion of long-term debt. Current ratio of 1.701:1 of its competitors indicates Wal-Mart's liquidity as being less satisfactory or insufficient.

(b) Quick ratio

It provides a more conservative assessment of liquidity by indicating the ability of the most highly liquid assets to meet current obligations (Brigham & Houston, 2010). Wal-Mart's

quick ratio was 0.273:1 in FY2010, which decreased by 2% to become 0.266:1. The wide spread between its current and quick ratio indicates that the company derives most of its liquidity via inventory which is supposed to be the least liquid asset. However, for retailers, inventory is not regarded as the least liquid, because it gets turned over very quickly. Comparison with its competitors' quick ratio of 0.995:1 shows that Wal-Mart has immense room for improvement.

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In a nutshell, Wal-Mart's liquidity seems less sufficient than its competitors; therefore, it is advisable that it should increase investment in short-term assets so that the proportion of liquidity driven by more liquid assets increases; in turn increasing its quick ratio. Moreover, the common-size analysis of its balance sheet shows that it carries current liabilities (34%) than long-term borrowing (26%), therefore, it is imperative for the company to improve its liquidity so that it short-term credit rating does not get downgraded.

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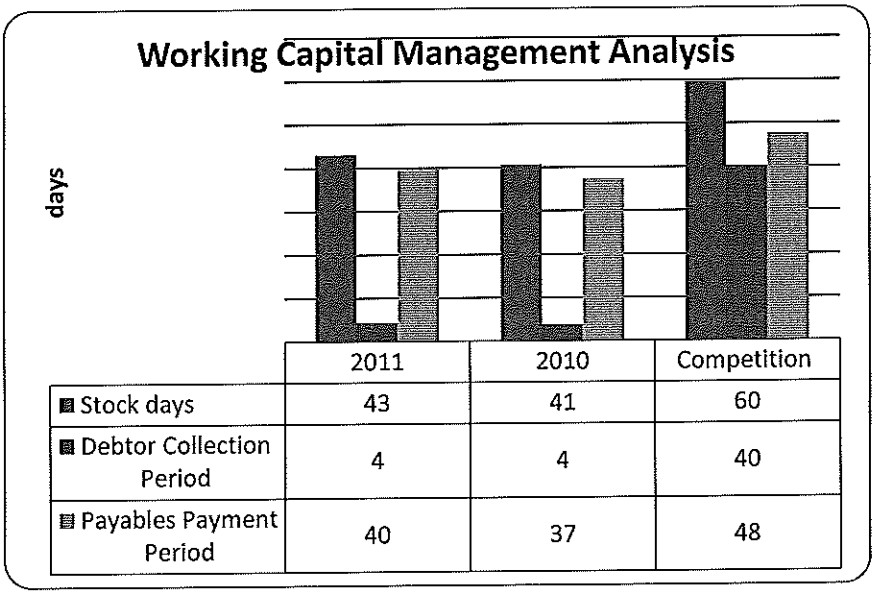
(ii). Working capital Management Analysis

For retailers, working capital management is one of the most significant financial performance areas. It is the sound management of their working capital, or assets employed to run business on daily basis, which supports their overall revenue and profit (Helfert, 2007).



	2011	2010	Competition
Stock days	43	41	60
Debtor Collection Period	4	4	40
Payables Payment Period	40	37	48

Chart 3

Working capital management analysis is carried out by assessing number of days stock is held for; debtor collection period; and payables payment period.

(a) Stock days

Stock-days indicates the number of days it takes for the inventory to get sold out and restocked (Atrill & McLaney, 2006). Wal-Mart's stock-days was 41days in FY2010, which increased by 6% to become 43days in FY2011. The increase in ratio could be attributed to 10% increase in stock, when its cost of goods sold increased by 3% only. Compared to the industry average of 60days, Wal-Mart's stock management seems highly efficient. It is vital to mention here that the objective for retailers' inventory management should be to match stock level with the demand; otherwise too much inventory would cause high inventory holding cost, damage or spoilage, whereas too low stock level would result in inability to fully meet customer demand (Pradhan, 2007). Hence, keeping in view Wal-Mart's revenue of $4.2b, its stock management is impeccable.

(b) Debtors' collection period

DCP indicates the number of days it takes for a company to receive cash from its customers on credit sales (Atrill & McLaney, 2006). Wal-Mart's debtors' collection period was 3 and half days in FY2010, which increased by 16% to become 4.7days or approximately 5 days. Such an increase could be attributed to 23% increase in receivables when its sales rose by 3% only; thus, Wal-Mart's management shows an inclination towards lenient customer credit policy. Compared to the industry average of 40days, the company is quite efficient in its receivables management. However, the possibility of its competitors' higher percentage of credit sales than Wal-Mart, could also be regarded as a factor for such a huge difference between the industry-average collection period and Wal-Mart's. Nevertheless, assuming that the company makes major portion of its sales on cash basis, it is advisable that its management should bear in mind that customer credit is an attractive policy to increase sales, as well as luring in prospective customers; however, an ultra-lenient policy can affect timely availability of funds

(c) Payables Payment Period

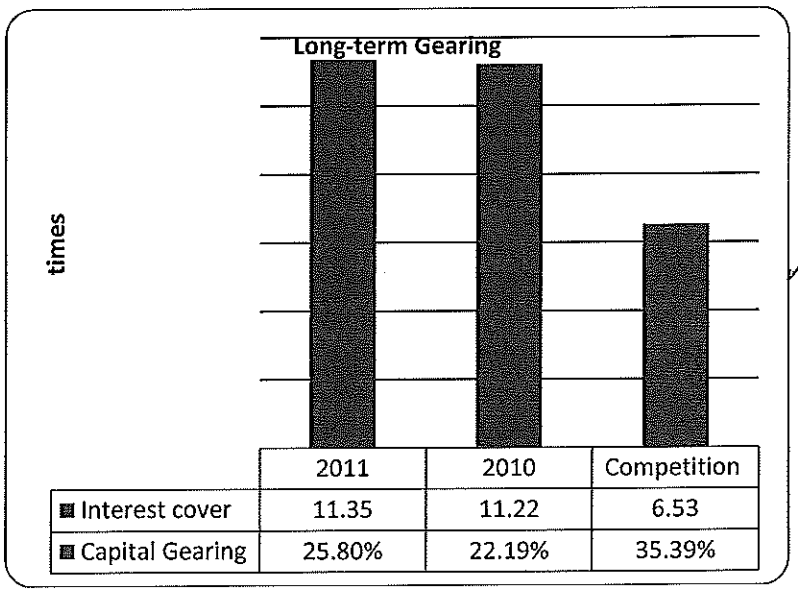
It indicates the number of days a company takes to pay its supplier for the purchases made (Atrill & McLaney, 2006). Wal-Mart's payables payment period was 37days which increased by 7% to become 40days (approx). The increase in the payment period could be attributed to 10% increase in accounts payable, which is in correspondence with increase in stock.

Compared to the industry average of 48days, Wal-Mart is more efficient in its debt management. By paying more quickly than its competitors, it is ensuring easy access to funds in future, as well as favourable purchase terms.

In a nutshell, working capital management analysis has made it evident that Wal-Mart's management has outdone its competitors with regard to managing its stock, debtors, and payables.

(iii). Long-term Gearing

Capital gearing or financial leverage indicates the proportion of debt in a company's capital structure; the higher the financial leverage, the higher is the financial risk (Shapiro & Balbirer, 2007). Financial leverage or debt requires borrowers to pay interest expense regardless of revenue or earnings; therefore, during unfavourable economic conditions when revenue and operating profit falls, payment of interest increases burden on earnings. The shrinkage of year-end profit due to high interest expense results in either quite low earnings or net losses altogether; thus forces the company to file for bankruptcy. However, during favourable conditions, financial leverage can magnify the return to investors; provided that the cost of borrowing is less than the return on investment (Megginson & Smart, 2009). The effect of financial leverage on Wal-Mart's profitability is highlighted in the profitability analysis.



	2011	2010	Competition
Interest cover	11.35	11.22	6.53
Capital Gearing	25.80%	22.19%	35.39%

Chart 4

(a) Capital Gearing

Wal-Mart's capital gearing ratio was 22.19% in FY2010, which increased by 16% to become 25.8% in FY2011. This increase could be attributed to 18% increase in long-term debt, when the company's reserves decreased by 4%, and share capital decreased by 3%, primarily driven by repurchasing of shares. The long-term debt issued was employed to pay or

refinance existing debt and for other general corporate purposes (WMT, A: 2011, p. 24). Compared to 35.39% of capital gearing in its competitor, Wal-Mart carries much lower financial risk, hence incurs lower cost of capital (Shapiro & Balbirer, 2007).

(b) Interest cover

This ratio helps measure the ability of a company's EBIT to cover interest expense (Atrill & McLaney, 2006); the higher it is, the lower is the financial risk. Wal-Mart's interest coverage was 11.22times in FY2010, which slightly increased to become 11.35times in FY2011. The increase is attributable to 7% increase in EBIT, when its interest expense rose by 5% only. The increase in EBIT was driven by 3.34%, 3.66%, and 11.05% increase in revenue, operating income, and non-operating income respectively. Its competitors, despite having higher financial leverage, have a much lower interest coverage of 6.53times, which signifies much higher financial risk for its competition.

In a nutshell, Wal-Mart is low-financially leveraged, as well as satisfactorily covers its interest expense well; therefore, carries much lower financial risk. This lower financial risk not only reduces its cost of capital but also strengthens is credit rating, which during FY2011 has been A-1+ and AA for short-term and long-term respectively (WMT, A: 2011, p. 25).

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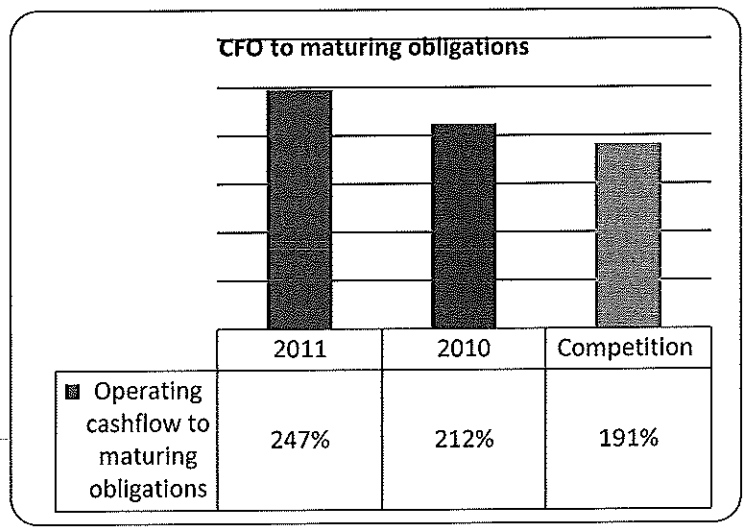
(iv). Cash flow ratios

Cash flow is regarded as more important element in assessing a company's financial performance than net profit, primarily because it is not affected by any accounting policy, hence, cannot be managed or manipulated easily (Brealey, Myers & Allen, 2009). Therefore, analysing relationship of cash flow generated with payment of debt, and other cash requiring activities is imperative to for a sound financial performance analysis. In this regard, cash flow from operating activities (CFO) to maturing obligations, free cash flow (FCF), and cash exhaustion ratios are being employed here.



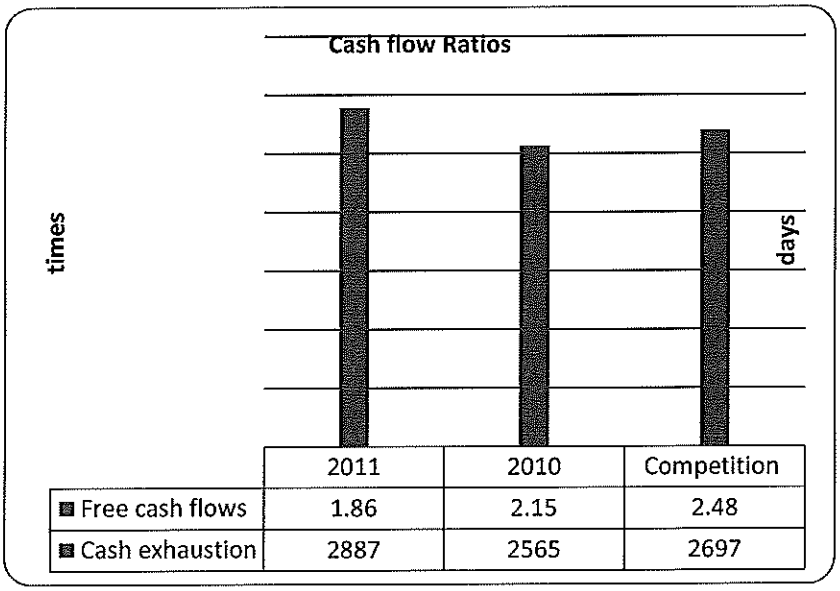
(a) CFO to maturing obligations

This ratio indicates the extent to which cash generated from a company's operations are able to meet current obligations (Bragg, 2007). The ratio was 212% in FY2010, which increased by 17% to become 247% in FY2011. The increase is attributable to a smaller change in current liabilities, when a larger change occurred in CFO Compared to the industry average of 191%, Wal-Mart's CFO is much stronger in covering its obligations in a timely manner.

Chart 5

(b) Free cash flow

FCF indicates the ability of a company's CFO to cover capital expenditure (Frank & Reilly, 2007). Wal-Mart's FCF was 2.15times in FY2010, which decreased by 14% to become 1.86times in FY2011. The decrease is attributable to 10% decrease in CFO, where as its capital expenditure rose by 4%. The decrease in CFO was primarily driven by decrease in funds from other operating activities, and increased investment in inventories (WMT, A: 2011, p. 23). The industry average of 2.48times establishes that Wal-Mart should improve its CFO so that its ability to cover capital expenditure can increase in future.



	2011	2010	Competition
Free cash flows	1.86	2.15	2.48
Cash exhaustion	2887	2565	2697

Chart 6

(c) Cash exhaustion

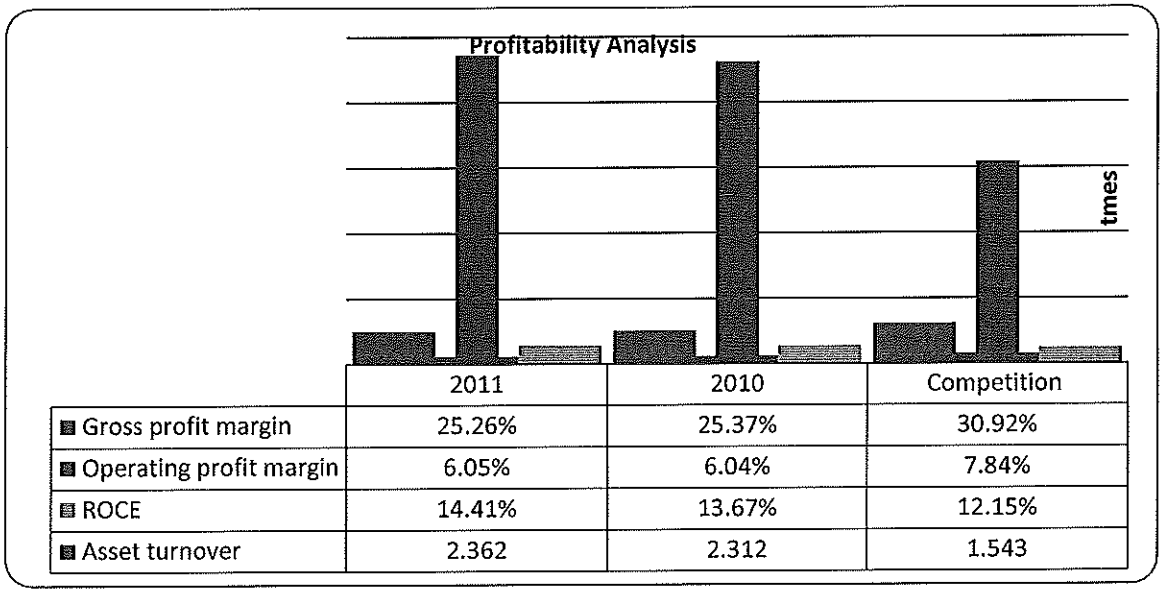
This ratio helps measure the number of days till which cash generated from operations can cover normal operating cost (Ryan, 2004). Wal-Mart's cash exhaustion ratio was 2,565days in FY2010, which decreased by 13% to become 2,887days in FY2011. The increase is attributable to a smaller change in cash-in-hand, when short-term obligations changed by a larger percentage. The decrease in cash-in-hand was driven by decrease in CFO during

FY2011. Compared to 2,697days of industry average, Wal-Mart's cash flow generation to cover normal operating cost is much stronger than its competitors'.

In a nutshell, Wal-Mart is comparatively performing much better with regard to cash flow management; however, it should improve its CFO so as to avoid exacerbating its financial performance in future.

(v). Profitability analysis

Profitability analysis helps assess the turnover, margins, and returns on investment made by financiers of a company (Hampton, 2007). GPM, OPM, ROCE, and ATO are the ratios employed here to assess Wal-Mart's profitability; the higher these are, the better it is.



	2011	2010	Competition
Gross profit margin	25.26%	25.37%	30.92%
Operating profit margin	6.05%	6.04%	7.84%
ROCE	14.41%	13.67%	12.15%
Asset turnover	2.362	2.312	1.543

Chart 7

(a) Gross Profit Margin (GPM) and Operating Profit Margin (OPM)

The percentage of revenue which finds its way to become gross profit is expressed via GPM, whereas the percentage of revenue which transforms into operating profit after covering operating expenses is expressed via OPM (Hampton, 2007). Wal-Mart's GPM remained almost stagnant at 25% during both the years; despite the fact that its revenue rose by 3.3%. Increase in the company's revenue is attributable to increased customer traffic, global expansion, and acquisition of Chilean subsidiary, Distribucióny Servicio S.A. de C.V;

however much of this increase was offset by unfavourable currency fluctuations in international Wal-Mart Segments (WMT, A. 2011, p. 17). Like GPM, its OPM has also shown a very slight change to become 6.05% in FY2011. The increase in margins was not significant because its revenue and expenses increased at the same rate during FY2011, which does not seem very healthy for the company's profitability. Moreover, industry average GPM and OPM at 30.9% and 7.84% respectively, substantiate the fact that Wal-Mart should improve margins to strengthen its profitability and CFO.

(b) Assets turnover

It indicates the efficiency and effectiveness with which assets of a company are being utilised to generate sales (Brigham & Houston, 2010). Wal-Mart's ATO increased by 2% to become 2.36times in FY2011; the increase can be attributed to 3% increase in sales when its capital/assets increased by 1.1% only. Compared to the industry average of 1.54times, Wal-Mart's assets-management-efficiency is quite satisfactory. It is vital to mention here that despite being much larger in size and scale, unlike its competitors, Wal-Mart is able to utilise its assets at full capacity,

(c) Return on Capital Employed

It shows the return each £ invested in a company's capital (Brealey, Myers & Allen, 2009). Wal-Mart's ROCE was 8.13% in FY2010, which increased by 5% to become 9.18% in FY2011. The increase in ROCE could be attributed to 7% increase in EBIT, and 18% increase in long-term liabilities. It is vital to mention here that ROCE is a function of assets turnover, profit margin, and financial leverage (Penman, 2003). Therefore, a breakdown of Wal-Mart's ROCE makes it evident that financial leverage and assets turnover are the primary factors driving Wal-Mart's profitability. Compared to 6.69% of average ROCE, Wal-Mart is surely more successful in providing better returns to its financiers. It is useful to recall here that retail industry is highly competitive; therefore, charging higher profit margin might drive decrease in sales, therefore retailers rely on higher asset turnover to strengthen profitability, which gets magnified by financial leverage (Penman, 2003).

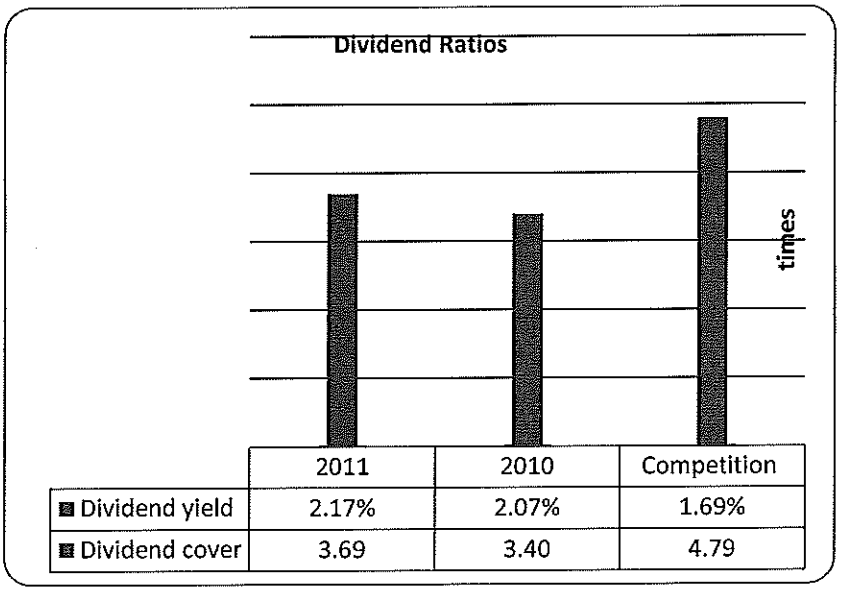
In a nutshell, Wal-Mart should reduce its cost and expenses, so that its margins could improve significantly. However, its favourable financial leverage and effective assets management help provide much better ROCE than its competitors.

(vi). Investment ratios

This set of ratios hold the highest significance for investors because it helps assess the direct return on investment made; in the shape capital gain and dividend income (Brealey, Myers & Allen, 2009). Dividend yield, dividend cover, EPS, and P/E ratios are employed to assess the stock's performance.

(a) Dividend yield

It shows the percentage return from dividend based upon a share's market price (Wahlen et al., 2011). Wal-Mart's dividend yield rose by 5% to become 2.17% in FY2011, as opposed to its industry average of 1.69%. The increment in yield could be attributed to 11% increase in dividend per share to become $1.21, when its market price rose by 6% to become $ 55.75. Higher yield on dividend than its competitors' makes Wal-Mart a more attractive option for prospective investors, as well as a more satisfactory option for its current shareholders.



	2011	2010	Competition
Dividend yield	2.17%	2.07%	1.69%
Dividend cover	3.69	3.40	4.79

Chart 8

(b) Dividend cover

It shows the number of times dividend could be paid out off current level of net profit (Wahlen et al., 2011). It rose by 9% to become 3.69times in FY2011, which is attributable to 14% increase in net profit, whereas dividend paid rose by 5% only. Compared to the industry average of 4.79times, Wal-Mart seems to lag behind in this respect. A plausible explanation can be its lower operational efficiency resulting in lower profit; in turn decreasing its ability to cover dividends.

(c) Earnings per share and Price to Earnings

EPS show the £ return on each share held, based upon a company's year-end profits (Atrill & McLaney, 2006); Wal-Mart's EPS have risen by 12%; principally driven by 14% increase in net profit and decrease in number of share outstanding because of its share-repurchase program. P/E, on the other hand, shows the price which investors are willing to for each £ of the company's future earnings; thus higher the expectations about future profitability, higher is the P/E (Brealey, Myes & Allen, 2009). Wal-Mart's P/E decreased by 6% to become 13.3 in FY2011, primarily because its EPS rose by double the change in its market price per share. The company's P/E was almost at par with industry average of 13.6 during FY2011.

In a nutshell, Wal-Mart's dividend policy has been effective enough to increase market attractiveness; however, their dividend coverage could be further improved if they could augment their margins. This increment in profitability would in turn, be reflected in its P/E in the long-run.

II. Analysis of Sources of Finance

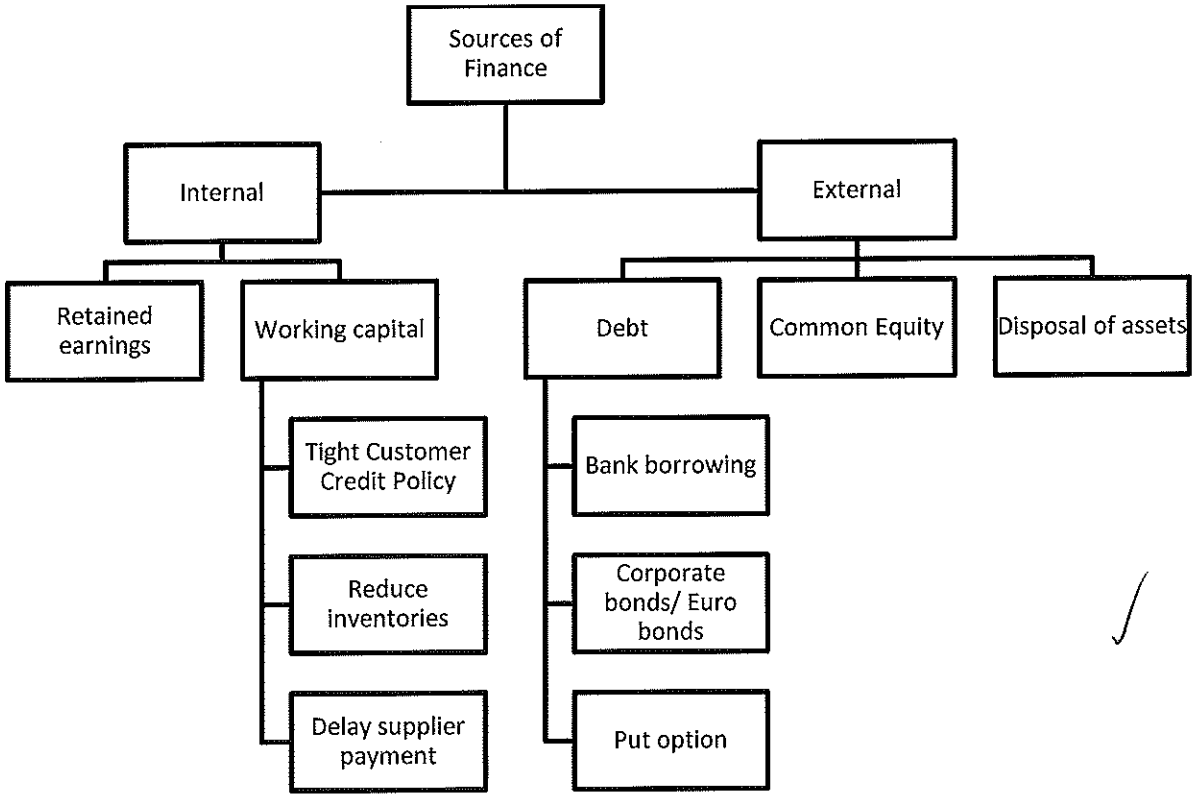


Figure 1 Wal-Mart's Sources of finance

There are various sources of internal and external financing options available to an MNC like Wal-Mart. Some of the major and most commonly employed are highlighted here; however, before analysing the sources, it is vital to briefly present the factors which affect the decision of employing internal and external sources of finance in the short-term or long-term.

1. It is imperative for a company to match its use of funds with the source of funds (Atrill & McLaney, 2006). In other words, sound financial planning employs short-term sources of funds to finance short-term uses, and likewise for long-term.
2. Assessing a degree of flexibility in making financing decision is also important; for e.g. if interest rates are expected to fall, it is wise to wait before raising funds via long-term debt. It is vital to mention here that an advantage of borrowing on short-term is that the borrower is not penalised for early payment, unlike in long-term (Atrill & McLaney, 2006). Nevertheless, opting for a short or long-term source requires a thorough assessment of the stages of need and the capital market conditions.
3. Another factor affecting the choice for long-term and short-term sources of finance is interest rate. Short-term debts have lower interest rate as compared to long-term, because of funds being engaged for shorter time period; hence there lies low or minimal risk of loss on investment; therefore, creditors require lower return (Atrill & McLaney, 2006).

Internal Sources of Finance

(i) Retained earnings

Companies can employ retained earnings as their funding; it is convenient because it does not require any outside party's involvement, hence is quicker. However, retaining funds in a larger proportion might result in unsatisfied investors, and consequent drop in P/E (Shapiro & Balbirer, 2007). Wal-Mart's retention ratio of 70% indicates their inclination towards employing retained earnings as one of their long-term internal sources of finance.

(ii) Working capital sources

Another internal source of finance could be derived from working capital;

a. By having a conservative customer credit policy, a company can receive cash more quickly which can be used for other purposes instead of being blocked in the shape of receivables (Atrill & McLaney, 2006). However, care has to be taken that too much tightness in credit policy might drive customers away to competitors. Wal-Mart does not seem to rely much on this type of funding, since it has recently experienced an increase in its receivables.
b. Holding lower level of stock can also provide funds for other purposes (Atrill & McLaney, 2006). Obviously holding higher stock means engaging funds in the shape stock for a longer period time; however, matching of stock-holding-level with demand is imperative. Wal-Mart, like receivables, does not seem to rely on this source of finance lately because it has increased its investment in stock during the year.
c. Delaying payment to suppliers is one the most commonly employed internal sources of finance (Atrill & McLaney, 2006). Making payment to suppliers as late as possible without affecting short-term credit rating enables companies to use those funds for some other purposes. Wal-Mart's 10% increase in accounts payable and 7% increase in payables payment period during FY2011 show its inclination towards using this option as a source of finance. ✓

External Sources of finance

(i) Debt

Issuing debt is one of the most common sources of finance for a company; may that be public or private. It is beneficial because it does not dilute management control, and its cheaper than equity issuance. However, it imposes burden on cash flows in the shape of interest expense and principal payment on maturity, and also increases the cost of equity (Shaprio & Balbirer, 2007). Two of the most commonly used instruments to raise funds via debt are bank borrowing and issuance of corporate bonds. Wal-Mart's short term borrowings consist of commercial paper and credit lines, which provide $1b and $523m of financing respectively (WMT, A: 2011, p. 40). It also has long-term bank borrowing arrangements which consist of $500m of debt embedded with put option, $30.4b unsecured USD debt, 6.4b Sterling, and 5.3b Yen denominated unsecured debt (WMT, A: 2011, p. 41). ✓

(ii) Ordinary Shares

Issuing ordinary shares is an external source of finance available to listed companies. It is advantageous because it does not require making interest payment regardless of revenue and income; paying interest reduces the taxes paid; and higher equity financing reduces the cost of debt (Shapiro & Balbirer, 2007). However, the disadvantages include cost of issuing shares being higher than the cost of issuing debt to raise the same amount of funds, and dilution of management control (Shapiro & Balbirer, 2007). Wal-Mart, being a listed company, employed 38% to 40% of common-equity financing during FY2011.

(iii) Disposal of assets

Sale of assets is also regarded a source of finance, albeit, a non-recurring one. Wal-Mart's statements highlight that it has employed it as a source of finance each year. Disposal of assets allowed the company to gain $1,002m in FY2010, and $489m in FY2011; it includes selling of property, plant, and equipment.

In a nutshell, analysis of sources of finance for Wal-Mart makes it evident that the company employs debt financing more than equity financing. This observation substantiates Pecking Order Theory, which asserts that debt is preferred to equity for raising funds, and internal funds are preferred to external funding (Ross, Westerfield & Jordan, 2008). The 60% of debt financing, and 70% of retention ratio for Wal-Mart provide a classic example of Pecking Order theory.

Conclusion

The financial performance analysis of Wal-Mart highlights that it has been successfully deriving exceptional returns, which are driven by high financial leverage and impeccable assets turnover. Its financial leverage is favourable because of its return on investment being greater than the cost of borrowing; therefore, the company is able to sustain its high long-term credit rating. Wal-Mart's liquidity, on the other hand, seems slightly less satisfactory than its competitors; however, excellent working capital management eliminates any short-term risk; thus strengthens its short-term credit rating. With regard to operational efficiency, the company has immense room to improve so that not only its margins but its CFO could improve as well. Lastly, Wal-Mart's management keeps its investors satisfied by consistently

increasing its dividend per share; thus higher dividend income and rising returns get reflected in the increase in its stock price prevailing in the secondary market.

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