

How to Read a 10-Q Like an Investment Professional: Sequel to Wal-Mart Analysis



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Webcast Agenda

1. Introduction to Case Study: Wal-Mart
2. Doing Your Homework: Advance Preparation for the 10-Q (quarterly)
 - Review 10-K (annual)
 - Maintain Historical Financials in Spreadsheet
 - Create Common-Size Financial Statements in Spreadsheet
 - Extract News Conclusions
3. Reviewing the Cash Flow Statement and What It Really Says
4. Process for Reading the 10-Q
5. Developing More-Detailed Questions for Management — Questions beyond Vague, Legalese Language
6. Questions and Answers

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About Jay Taparia, CFA

- On behalf of CFA Institute, a public speaker/educator of business journalists on financial statement analysis, accounting tomfoolery, and corporate finance issues since 2001.
- Author of *Understanding Financial Statements for Journalists* (www.marionstreetpress.com or www.amazon.com).
- Finance lecturer, University of Illinois at Chicago, in financial management, corporate finance, investments/personal finance, and international finance since 1999.
- CEO, Sanskar Investments, Chicago. Former senior portfolio manager, Bank One Investment Advisors.

Case Study: Wal-Mart

- We are continuing the Case Study from our "Earnings Release" Webcast on December 6, 2005.
- Case Study company: Wal-Mart
- Press release analysis of Wal-Mart focused on:
 - Sales up, but Net Income up by less than Sales Growth Change
 - Declining margins, *possibly* due to high competition
 - Greater incremental cost of gaining market share
 - Harder to cut more costs to take more market share
 - In latest quarter, discussion of margin expansion nonexistent in light of Katrina/Rita (key investment issue not discussed)
- The story continues with the release of the 10-Q dated October 31, 2005.

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**Doing Your Homework:
Advance Preparation for the 10-Q**

1. Know the most recent 10-K
 - The 10-Q is a key update to the 10-K. You need some initial context of comparison.
 - In particular, read the “Key Risk Factors” section on what can hurt the company’s operations and thus the stock price. Watch for these factors in the 10-Q filing.

**Wal-Mart’s Key Risk Factors
From January 31, 2005 10-K**

- General economic and other conditions — domestic and international — may adversely affect our financial performance.
- We may face impediments to our expansion in the United States, including conversions of discount stores into supercenters.
- Impediments to the expansion of our international operations could adversely affect our financial performance.
- Failure to attract and retain qualified associates and other labor issues could adversely affect our financial performance.

**Wal-Mart’s Key Risk Factors (cont’d)
From January 31, 2005 10-K**

- We face strong competition from other retailers and wholesale club operators.
- Risks associated with the vendors from whom our products are sourced could adversely affect our financial performance.
- Our international operations subject us to risks associated with the legislative, judicial, accounting, regulatory, political, and economic conditions specific to the countries or regions in which we operate.
- We are subject to certain legal proceedings that may affect our financial condition and results of operation.

**Doing Your Homework:
Advance Preparation for the 10-Q**

What did we learn from reading the 10-K and from our last conference call?

- Company Strategy — Every Day Low Pricing (EDLP)
- Wide Variety of Product Lines — bulk purchasing and highly efficient distribution system to keep prices low
- Logistics System for Distribution — 88% of products shipped from 99 distribution centers around the U.S.
- Domestic Growth — via new store openings and store conversions
- International Growth Strategy — primarily via acquisitions
- Competition Strong — domestic and international — putting constant margin pressure on company

**Doing Your Homework:
Advance Preparation for the 10-Q**

3. For more in-depth analysis, maintain a 12-quarter or annual (or longer) rolling history of the Income Statement, Balance Sheet, and Cash Flow Statement in an Excel spreadsheet.

Look for trends the press release may not highlight.

Review Cash Flow Statement and Balance Sheet in particular since Income Statement is only half of the story.

**Wal-Mart’s
Income Statement (2001-2005)**

Amount in \$millions	Year Ended January 31				
	2001	2002	2003	2004	2005
Net Sales	191,329	204,011	229,616	256,329	285,222
Other Income	1,787	1,812	1,961	2,352	2,767
Total Revenue	193,116	205,823	231,577	258,681	287,989
Cost of Sales	150,255	159,097	178,299	198,747	219,793
Gross Margin	42,861	46,726	53,278	59,934	68,196
Operating Costs	31,550	35,147	39,983	44,909	51,105
Operating Income	11,311	11,579	13,295	15,025	17,091
Interest Expense	1,195	1,183	927	832	986
Taxable Income	10,116	10,396	12,368	14,193	16,105
Tax Expense	3,692	3,765	4,357	5,118	5,589
Net Income	6,424	6,631	8,011	9,075	10,516

Wal-Mart's Balance Sheet (2001-2005) — Assets

Amount in \$Millions	Year Ended January 31				
	2001	2002	2003	2004	2005
Current Assets					
Cash and Equivalents	2,054	2,161	2,758	5,199	5,488
Accounts Receivable	1,768	2,000	2,108	1,254	1,715
Inventory	21,442	22,614	24,891	26,612	29,447
Prepaid Exp. & Other	1,291	1,103	726	1,356	1,841
Total Current Assets	26,555	27,878	30,483	34,421	38,491
Property & Equipment					
Land	9,433	10,241	11,228	12,699	14,472
Buildings & Improv.	29,157	33,153	38,564	44,478	51,579
Fixtures & Equip.	12,964	14,135	15,946	17,934	21,461
Transportation Equip.	879	1,089	1,313	1,269	1,530
Total Property & Equipment	52,433	58,618	67,051	76,380	89,042
Less: Accum. Depreciation	11,499	12,868	15,147	17,357	20,475
Net Property & Equipment	40,934	45,750	51,904	59,023	68,567
Goodwill	9,059	8,566	9,521	9,882	10,803
Other Assets	1,582	1,333	2,777	2,079	2,362
Total Assets	78,130	83,527	94,685	105,405	120,223

Wal-Mart's Balance Sheet (2001-2005) — Liabilities & Equity

Amount in \$Millions	Year Ended January 31				
	2001	2002	2003	2004	2005
Current Liabilities					
Commercial Paper	2,286	743	1,079	3,267	3,812
Accounts Payable	15,092	15,617	17,140	19,425	21,671
Accrued Liabilities	6,355	7,174	8,945	10,671	12,155
Accrued Income Taxes	841	1,343	739	1,377	1,281
LT Debt Due Within 1 Year	4,234	2,257	4,538	2,904	3,759
Capital Leases Within 1 Year	141	148	176	196	210
Total Current Liabilities	28,949	27,282	32,617	37,840	42,888
Long-Term Debt	12,501	15,687	16,607	17,102	20,087
Capital Leases	3,154	3,045	3,001	2,997	3,582
Other LT Liabilities	2,183	2,411	3,123	3,843	4,270
Total Liabilities	46,787	48,425	55,348	61,782	70,827
Shareholders' Equity					
Common Stock Par Value	447	445	440	431	423
Paid-in Capital	1,411	1,484	1,482	2,135	2,425
Retained Earnings	30,169	34,441	37,924	40,206	43,854
Other Equity	-684	-1,268	-509	851	2,694
Total Equity	31,343	35,102	39,337	43,623	49,396
Total Liabilities and Equity	78,130	83,527	94,685	105,405	120,223

Wal-Mart's Cash Flow Statement Cash Flow from Operating & Investing (2001-2005)

Amount in \$Millions	Year Ended January 31				
	2001	2002	2003	2004	2005
Cash Flow from Operating Activities					
Net Income from Continuing Operations	6,295	6,448	7,818	8,861	10,267
Depreciation/Amortization	2,868	3,228	3,364	3,852	4,405
Deferred Income Taxes	342	140	474	177	263
Other Non-Cash Expenses (Income)	244	504	767	223	378
Changes in Working Capital					
Decr (Incr) in Accounts Receivable	(422)	(212)	(159)	373	(304)
Decr (Incr) in Inventory	(1,795)	(1,125)	(2,219)	(1,973)	(2,635)
Incr (Decr) in Accounts Payable	2,061	416	1,748	2,587	1,694
Incr (Decr) in Accrued Liabilities	11	1,120	1,212	1,896	976
Net Cash Provided by Operating Activities	9,604	10,519	13,005	15,996	15,044
Cash Flow from Investing Activities					
Purchase of Property, Equipment	(8,042)	(8,285)	(9,245)	(10,308)	(12,893)
Investment in International Operations	(627)	0	(749)	(38)	(315)
Proceeds from Disposal of Fixed Assets	0	248	311	481	953
Proceeds from Sale of Discontinued Operations	0	(89)	(83)	1,475	0
Other Investing Activities	(45)	903	(73)	78	(96)
Net Cash Used in Investing Activities	(8,714)	(7,223)	(9,839)	(8,312)	(12,351)

Wal-Mart's Cash Flow Statement Cash Flow from Financing Activities (2001-2005)

Amount in \$Millions	Year Ended January 31				
	2001	2002	2003	2004	2005
Cash Flow from Financing Activities					
Increase in Commercial Paper	(2,022)	(1,533)	1,836	688	544
Proceeds from Issuance of LT Debt	3,778	4,591	2,044	4,099	5,832
Sale (Purchase) of Company Stock	388	(1,214)	(3,383)	(5,046)	(4,549)
Dividends Paid	(1,070)	(1,249)	(1,328)	(1,569)	(2,214)
Payment of LT Debt	(1,519)	(3,519)	(1,261)	(3,541)	(2,131)
Payment of Capital Leases	(173)	(167)	(216)	(305)	(204)
Other Financing Activities	176	113	(62)	111	113
Net Cash Used in Financing Activities	(442)	(2,978)	(2,370)	(5,563)	(2,609)
Effect of Exchange Rate Changes on Cash	(250)	(211)	(199)	320	205
Net Increase in Cash & Equivalents	198	107	597	2,441	289
Cash Balance at Beginning of Year	1,856	2,054	2,161	2,758	5,199
Cash Balance at End of Year	2,054	2,161	2,758	5,199	5,488

Doing Your Homework: Advance Preparation for the 10-Q

4. Take the 12-quarter rolling history of the income statement and balance sheet and convert to "common-size."

"Common-size" financial statements convert whole numbers to percentages to make relative comparisons possible.

Take each line item as a % of Revenue on Income Statement — so that margins and costs as a % of sales can be compared over time — a strong measure of operating efficiency, profitability, and the success of management strategies.

Take each line item as a % of Total Assets on Balance Sheet — so that Assets and Debt Levels can be compared over time — a strong measure of ability to finance and efficient asset use. Compare current year quarter to previous year quarter — to eliminate seasonality effects.

Wal-Mart Common-Size Income Statement (2001-2005)

% of Total Revenue	Year Ended January 31				
	2001	2002	2003	2004	2005
Net Sales	99.1%	99.1%	99.2%	99.1%	99.0%
Other Income	0.9%	0.9%	0.8%	0.9%	1.0%
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Sales	77.8%	77.3%	77.0%	76.8%	76.3%
Gross Margin	22.2%	22.7%	23.0%	23.2%	23.7%
Operating Costs	16.3%	17.1%	17.3%	17.4%	17.7%
Operating Income	5.9%	5.6%	5.7%	5.8%	5.9%
Interest Expense	0.6%	0.6%	0.4%	0.3%	0.3%
Taxable Income	5.2%	5.1%	5.3%	5.5%	5.6%
Tax Expense	1.9%	1.8%	1.9%	2.0%	1.9%
Net Income	3.3%	3.2%	3.5%	3.5%	3.7%

Wal-Mart's Common-Size Balance Sheet (2001-2005) — Assets

% of Total Assets	Year Ended January 31				
	2001	2002	2003	2004	2005
Current Assets					
Cash and Equivalents	2.6%	2.6%	2.9%	4.9%	4.6%
Accounts Receivable	2.3%	2.4%	2.2%	1.2%	1.4%
Inventory	27.4%	27.1%	26.3%	25.2%	24.5%
Prepaid Exp. & Other	1.7%	1.3%	0.8%	1.3%	1.5%
Total Current Assets	34.0%	33.4%	32.2%	32.7%	32.0%
Property & Equipment					
Land	12.1%	12.3%	11.9%	12.0%	12.0%
Buildings & Improv.	37.3%	39.7%	40.7%	42.2%	42.9%
Fixtures & Equip.	16.6%	16.9%	16.8%	17.0%	17.9%
Transportation Equip.	1.1%	1.3%	1.4%	1.2%	1.3%
Total Property & Equipment	67.1%	70.2%	70.8%	72.5%	74.1%
Less: Accumulated Depreciation	14.7%	15.4%	16.0%	16.5%	17.0%
Net Property & Equipment	52.4%	54.8%	54.8%	56.0%	57.0%
Goodwill	11.6%	10.3%	10.1%	9.4%	9.0%
Other Assets	2.0%	1.6%	2.9%	2.0%	2.0%
Total Assets	100.0%	100.0%	100.0%	100.0%	100.0%

Wal-Mart's Common-Size Balance Sheet (2001-2005) — Liabilities & Equity

% of Total Assets	Year Ended January 31				
	2001	2002	2003	2004	2005
Current Liabilities					
Commercial Paper	2.9%	0.9%	1.1%	3.1%	3.2%
Accounts Payable	19.3%	18.7%	18.1%	18.4%	18.0%
Accrued Liabilities	8.1%	8.6%	9.4%	10.1%	10.1%
Accrued Income Taxes	1.1%	1.6%	0.8%	1.3%	1.1%
LT Debt Due Within 1 Year	5.4%	2.7%	4.8%	2.8%	3.1%
Capital Leases Within 1 Year	0.2%	0.2%	0.2%	0.2%	0.2%
Total Current Liabilities	37.1%	32.7%	34.4%	35.9%	35.7%
Long-Term Debt	16.0%	18.8%	17.5%	16.2%	16.7%
Capital Leases	4.0%	3.6%	3.2%	2.8%	3.0%
Other LT Liabilities	2.8%	2.9%	3.3%	3.6%	3.6%
Total Liabilities	59.9%	58.0%	58.5%	58.6%	58.9%
Shareholders' Equity					
Common Stock Par Value	0.6%	0.5%	0.5%	0.4%	0.4%
Paid-In Capital	1.8%	1.8%	1.6%	2.0%	2.0%
Retained Earnings	38.6%	41.2%	40.1%	38.1%	36.5%
Other Equity	-0.9%	-1.5%	-0.5%	0.8%	2.2%
Total Equity	40.1%	42.0%	41.5%	41.4%	41.1%
Total Liabilities and Equity	100.0%	100.0%	100.0%	100.0%	100.0%

Key Conclusions from "Homework"

- Profitability growing steadily
 - Margins growing slowly, but
 - Operating Costs seem to be growing faster as a % of Sales
 - Operating Costs are largely fixed and large % of Gross Margin
 - Net Income margins very small — 3-5% — implying little room for error in company strategy and in dealing with competition
- News** → Can volume growth maintain profit margins? Volume growth is driven by new stores, acquisitions, and increases in same-store sales. What product and pricing strategy can the company implement to keep margins stable and strong?
- Also, debt levels are stable and, in fact, slowly decreasing.

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Definition of Cash Flow

- If a company reports earnings of \$1 billion, does this mean it has this amount of cash in the bank? Not necessarily. Financial statements are based on accrual accounting, which takes into account non-cash items and records revenue or expenses when a transaction takes place but no cash is exchanged.
- However, *accrual accounting may create timing differences — where a transaction is recorded but no cash is transacted.* The Statement of Cash Flow reconciles this information and reflects when the cash actually "flowed."
- Cash Flow is how much cash is flowing into or out of the company — this is a key indicator of financial strength, but more importantly, "solvency" — can the company pay its bills and still survive?

Key Metrics for Measuring Cash Flow and Cash Flow Growth

$$\frac{\text{Net Cash Flow} + \text{Change in Working Capital}}{\text{Cash Flow from Operations}}$$

As found in Cash Flow Statement

$$\frac{\text{Cash Flow from Operations} - \text{Purch of Prop, Plant, Equip}}{\text{Free Cash Flow}}$$

What Does the Cash Flow Statement Really Tell You?

- Presents a clearer picture of operations
 - Catches artificial and year-end extraordinary sales
 - Restructuring charges are converted to cash flows
 - Unlike net income, cash flows are generally real
- Management actions: cash sources
 - Asset or business liquidation
 - Major debt issue
 - Stock issue
- Management actions: cash uses
 - Internal growth
 - Acquisitions
 - Pay off debt or repurchase common stock
- Bottom Line? Cash Flow Growth (NOT Earnings Per Share Growth) drives the market value of the company (and eventually the stock price). Earnings Per Share is just one part of the driving force — as part of Cash Flow.

Wal-Mart's Cash Flow Statement Cash Flow from Operating & Investing (2001-2005)

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Incr (Decr) in Accrued Liabilities	11	1,120	1,212	1,896	976
Net Cash Provided by Operating Activities	9,604	10,519	13,005	15,996	15,044
Cash Flow from Investing Activities					
Purchase of Property, Equipment	(8,042)	(8,285)	(9,245)	(10,308)	(12,893)
Investment in International Operations	(627)	0	(749)	(38)	(315)
Proceeds from Disposal of Fixed Assets	0	248	311	481	953
Proceeds from Sale of Discontinued Operations	0	(89)	(83)	1,475	0
Other Investing Activities	(45)	303	(73)	78	(96)
Net Cash Used in Investing Activities	(8,714)	(7,223)	(9,839)	(8,312)	(12,351)

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Increase in Commercial Paper	(2,022)	(1,533)	1,836	688	544
Proceeds from Issuance of LT Debt	3,778	4,591	2,044	4,099	5,832
Sale (Purchase) of Company Stock	388	(1,214)	(3,383)	(5,046)	(4,549)
Dividends Paid	(1,070)	(1,249)	(1,328)	(1,569)	(2,214)
Payment of LT Debt	(1,519)	(3,519)	(1,261)	(3,541)	(2,131)
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Net Increase in Cash & Equivalents	198	107	597	2,441	289
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Key Metrics for Measuring Cash Flow and Cash Flow Growth

$$\frac{\text{Net Cash Flow} + \text{Change in Working Capital}}{\text{Cash Flow from Operations}} \quad \text{As found in Cash Flow Statement}$$

$$\frac{\text{Cash Flow from Operations} - \text{Purch of Prop, Plant, Equip}}{\text{Free Cash Flow}}$$

Key Metrics for Measuring Cash Flow and Cash Flow Growth

$$\frac{\text{Net Cash Flow} + \text{Change in Working Capital}}{\text{Cash Flow from Operations}} \quad \frac{\text{Cash Flow from Operations} - \text{Purch of Prop, Plant, Equip}}{\text{Free Cash Flow}}$$

Amount in \$Millions	Year Ended January 31				
	2001	2002	2003	2004	2005
Cash Flow from Operations	9,604	10,519	13,005	15,996	15,044
Less: Purchase of Property, Equipment	(8,042)	(8,285)	(9,245)	(10,308)	(12,893)
Less: Investment in International Operations	(627)	0	(749)	(38)	(315)
Equals: Free Cash Flow	935	2,234	3,011	5,650	1,836

Always Recommended to Compare Change in Free Cash Flow vs. Change in Profit Margins

Gross Margin %	22.2%	22.7%	23.0%	23.2%	23.7%
Operating Margin %	5.9%	5.6%	5.7%	5.8%	5.9%
Net Income Margin %	3.3%	3.2%	3.5%	3.5%	3.7%

Conclusions from Cash Flow Metrics

- Cash Flow from Operations steadily growing
 - Strength in Net Cash Flow from the business
 - Operating efficiencies in Accounts Payable helping offset increases in Inventory
- Purchase of Property and Equipment (PP&E) steadily increasing
 - A.k.a. new store expansion and growth
 - Funded largely by Cash Flow from Operations (being a large percentage of such cash flows)
- Excess Cash Flow after PP&E (Free Cash Flow) directed toward stock buybacks and debt repayments
 - However, Free Cash Flow growth not consistently growing versus profit margins — is such aggressive expansion and store conversion really resulting in sustainable and high margins?

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Process of Reading the 10-K Report

1. Review the key points of Wal-Mart's news.
 - In other words, keep in mind company's strategy of store growth, store conversion, acquisition, and margin growth via EDLP.
2. Enter quarterly financials into spreadsheet and calculate rolling 4-quarter average and common-size statements — for Income and Cash Flow Statements.
 - Do not worry about the 4-quarter average for Balance Sheet — Accountants call this a "Stock Account" — indicating "how much of a particular item" (not to be confused with shares).
 - What you have is what you have at any point in time. Review on a quarterly basis.

1st Quarter, 2004 Rolling Average Quarterly Income Statement

Amount in \$Millions	Year End		Year End			ROLLING LAST 4 QUARTER			
	1/31/2004	1/31/05	1/31/2005	4/30/05	7/31/05	10/31/05	4/30/05	7/31/05	10/31/05
Net Sales	256,329	82,217	285,222	70,908	76,811	75,436	291,367	298,456	305,372
Other Income	2,352	588	2,767	772	709	817	2,859	2,831	2,886
Total Revenue	258,681	82,805	287,989	71,680	77,520	76,253	294,226	301,287	308,258
Cost of Sales	198,747	63,724	219,793	54,571	58,787	57,988	224,395	229,649	235,070
Gross Margin	59,934	19,081	68,196	17,109	18,733	18,265	69,831	71,638	73,188
Operating Costs	44,909	13,783	51,105	13,168	14,054	14,216	52,404	53,936	55,221
Operating Income	15,025	5,298	17,091	3,941	4,679	4,049	17,427	17,702	17,967
Interest Expense	832	298	986	200	302	349	978	1,041	1,149
Taxable Income	14,193	5,000	16,105	3,741	4,377	3,700	16,449	16,661	16,818
Tax Expense	5,118	1,735	5,589	1,212	1,503	1,254	5,612	5,657	5,704
Net Income	9,075	3,265	10,516	2,529	2,874	2,446	10,837	11,004	11,114

1st Quarter, 2004 Rolling Average Quarterly Common-Size Income Statement

Amount in \$Millions	Year End		Year End			ROLLING LAST 4 QUARTER			
	1/31/2004	1/31/05	1/31/2005	4/30/05	7/31/05	10/31/05	4/30/05	7/31/05	10/31/05
Net Sales	99.1%	99.3%	99.0%	98.9%	99.1%	98.9%	99.0%	99.1%	99.1%
Other Income	0.9%	0.7%	1.0%	1.1%	0.9%	1.1%	1.0%	0.9%	0.9%
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Sales	76.8%	77.0%	76.3%	76.1%	75.8%	76.0%	76.3%	76.2%	76.3%
Gross Margin	23.2%	23.0%	23.7%	23.9%	24.2%	24.0%	23.7%	23.8%	23.7%
Operating Costs	17.4%	16.6%	17.7%	18.4%	18.1%	18.6%	17.8%	17.9%	17.9%
Operating Income	5.8%	6.4%	5.9%	5.5%	6.0%	5.3%	5.9%	5.9%	5.8%
Interest Expense	0.3%	0.4%	0.3%	0.3%	0.4%	0.5%	0.3%	0.3%	0.4%
Taxable Income	5.5%	6.0%	5.6%	5.2%	5.6%	4.9%	5.6%	5.5%	5.5%
Tax Expense	2.0%	2.1%	1.9%	1.7%	1.9%	1.6%	1.9%	1.9%	1.9%
Net Income	3.5%	3.9%	3.7%	3.5%	3.7%	3.2%	3.7%	3.7%	3.6%

Process of Reading the 10-K

3. Read the management discussion on what the quarter was like and track any changes associated with specific events (such as acquisitions/divestitures). For Wal-Mart, this includes:
 - Profit margins are the key issue,
 - Business is clearly volume driven, and
 - No room for management error or absorbing catastrophes.
4. Review rolling average of Cash Flow Statement
 - To see key changes in specific line items and
 - Tracking cash flow metrics such as Cash Flow from Operations and Free Cash Flow.

3rd Quarter, 2005 Rolling Average Quarterly Cash Flow Statements

Amount in \$Millions	Year End		Year End			ROLLING LAST 4 QUARTER			
	1/31/2004	1/31/05	1/31/2005	4/30/05	7/31/05	10/31/05	4/30/05	7/31/05	10/31/05
Cash Flow from Operating Activities									
Net Income from Continuing Operations	8,861	3,164	10,267	2,461	2,805	2,374	10,562	10,716	10,804
Depreciation/Amortization	3,852	1,244	4,405	1,132	1,251	1,131	4,500	4,720	4,758
Deferred Income Taxes	177	263	263	0	0	0	263	263	263
Other Non-Cash Expenses (Income)	223	67	378	(44)	(206)	817	187	100	634
Changes in Working Capital									
Deor (Incr) in Accounts Receivable	373	(260)	(304)	185	(124)	(136)	(256)	(313)	(334)
Deor (Incr) in Inventory	(1,973)	3,997	(2,635)	(1,917)	805	(5,561)	(2,922)	(2,457)	(2,676)
Incr (Deor) in Accounts Payable	2,587	(1,405)	1,694	1,040	(291)	2,433	2,741	2,460	1,777
Incr (Deor) in Accrued Liabilities	1,896	526	976	(344)	(212)	514	1,615	1,223	484
Net Cash Provided by Operating Activities	15,996	7,596	15,044	2,913	4,628	1,573	15,699	16,712	15,710
Cash Flow from Investing Activities									
Purchase of Property, Equipment	(10,308)	(3,633)	(12,893)	(2,772)	(3,761)	(3,932)	(13,020)	(13,672)	(14,838)
Investment in International Operations	(38)	0	(315)	0	0	(307)	0	0	(307)
Proceeds from Disposal of Fixed Assets	481	211	953	301	114	324	1,012	861	950
Proceeds from Sale of Discontinued Operations	1,475	0	0	0	0	0	0	0	0
Other Investing Activities	78	3	(96)	(25)	(82)	(15)	(57)	29	(119)
Net Cash Used in Investing Activities	(8,312)	(3,419)	(12,351)	(2,496)	(3,669)	(3,939)	(12,065)	(12,762)	(13,514)

3rd Quarter, 2005 Rolling Average Quarterly Cash Flow Statements

Amount in \$Millions	Year End			Year End			ROLLING LAST 4 QUARTER		
	10/31/2004	1/31/05	10/31/2005	4/30/05	7/31/05	10/31/05	4/30/05	7/31/05	10/31/05
Cash Flow from Financing Activities									
Increase in Commercial Paper	888	(3,758)	544	3,205	2,037	(2,280)	2,855	2,227	(798)
Proceeds from Issuance of LT Debt	4,099	1,001	5,832	0	2,000	4,040	3,817	5,798	7,341
Payment of LT Debt	(3,841)	(50)	(2,131)	(1,508)	(533)	(881)	(3,802)	(3,584)	(2,772)
Sale (Purchase) of Company Stock	(5,046)	(151)	(4,549)	(1,415)	(2,168)	0	(4,021)	(4,621)	(3,731)
Dividends Paid	(1,569)	(550)	(2,214)	(635)	(627)	(625)	(2,291)	(2,364)	(2,437)
Payment of Capital Leases	(305)	(204)	(204)	0	0	0	(204)	(204)	(204)
Other Financing Activities	111	218	113	(156)	(305)	(154)	(149)	(313)	(387)
Net Cash Used in Financing Activities	(5,563)	(3,494)	(2,609)	(509)	407	1,200	(3,595)	(3,071)	(2,396)
Effect of Exchange Rate Changes on Cash	320	166	205	(41)	(48)	19	97	105	96
Net Increase in Cash & Equivalents	2,441	849	289	(533)	718	(1,138)	1,127	964	(104)

3rd Quarter, 2005 Rolling Average Quarterly Cash Flow Metrics

Net Cash Flow
+/- Change in Working Capital
Cash Flow from Operations

Cash Flow from Operations
- Purch of Prop, Plant, Equip
Free Cash Flow

Amount in \$Millions	Year End			Year End			ROLLING LAST 4 QUARTER		
	1/31/2004	1/31/05	1/31/2005	4/30/05	7/31/05	10/31/05	4/30/05	7/31/05	10/31/05
Cash Flow from Operations	15,996	7,596	15,044	2,513	4,028	1,573	16,690	16,712	15,710
Less: Purchase of Property, Equipment	(10,308)	(3,633)	(12,893)	(2,772)	(3,701)	(3,932)	(13,028)	(13,072)	(14,038)
Less: Investment in International Operations	(38)	0	(315)	0	0	(307)	0	0	(307)
Equals: Free Cash Flow	5,650	3,963	1,836	(259)	327	(2,666)	3,670	3,640	1,365

Process of Reading the 10-Q Quoted from Wal-Mart's 2nd Quarter, 10/31/05 Report

1. Key items in the second quarter — Significant financial items related to the second quarter of fiscal 2005 include:
 - Net sales for the second quarter of fiscal 2006 increased 10.2% to \$76.8 billion from \$69.7 billion in the second quarter of fiscal 2005.
 - Net income increased 5.8% to \$2.8 billion, or \$0.67 per share, in the second quarter of fiscal 2006.
 - Comparative store sales in the U.S. increased 3.5% for the quarter ended July 31, 2005, which compares with a 4.2% increase for the quarter ended July 31, 2004. Comparative store sales at our Wal-Mart Stores segment increased 3.6% for the second quarter of fiscal 2006 compared with 3.3% in the second quarter of fiscal 2005. SAM'S CLUB's comparative store sales increased 2.9% in the second quarter of fiscal 2006 compared with 8.8% in the second quarter of fiscal 2005.

Process of Reading the 10-Q Quoted from Wal-Mart's 2nd Quarter, 10/31/05 Report

2. Other financial information:
 - The increase in the International segment's net sales as a percentage of total net sales is largely due to the \$679 million favorable impact of foreign exchange on the International segment's net sales in the second quarter of fiscal 2006. Additionally, the decrease in the SAM'S CLUB segment's net sales as a percentage of total net sales resulted from the more rapid development of new stores in the Wal-Mart Stores and International segments than the SAM'S CLUB segment. (p.s. clearly this is one time and not a sustainable way of keeping margins!)
 - Our total gross profit as a percentage of sales (our "gross margin") increased from 23.2% in the second quarter of fiscal 2005 to 23.5% during the second quarter of fiscal 2006. Because the Wal-Mart Stores segment and International segment sales yield higher gross margins than does the SAM'S CLUB segment, the greater increases in net sales for the Wal-Mart Stores and International segments had a favorable impact on the company's total gross margin.

Process of Reading the 10-Q Quoted from Wal-Mart's 2nd Quarter, 10/31/05 Report

2. Other financial information:
 - Operating, selling, general, and administrative expenses ("operating expenses") as a percentage of net sales were 18.3% for the second quarter of fiscal 2006, up from 18.0% in the corresponding period in fiscal 2005. This increase was primarily due to increases in payroll, utility, maintenance, and repair costs.
3. Myriad pending lawsuits
 - No really large dollar amounts relative to company's size, but they create potential for increased structural costs, given the number of people in the class-action lawsuits. Areas of lawsuit primarily include labor and health care benefit issues.

Webcast Agenda

1. Introduction to Case Study: Wal-Mart
2. Doing Your Homework: Advance Preparation for the 10-Q (quarterly)
 - Review 10-K (annual)
 - Maintain Historical Financials in Spreadsheet
 - Create Common-Size Financial Statements in Spreadsheet
 - Extract News Conclusions
3. Reviewing the Cash Flow Statement and What It Really Says
4. Process for Reading the 10-Q
5. Developing More-Detailed Questions for Management — Questions beyond Vague, Legalese Language
6. Questions and Answers

Key Questions for Senior Management All Relating to Profit Margin Question

- What mix of product (new and old) are you targeting? Wal-Mart is already the largest toy reseller and grocery store in the nation; what else is in the pipeline?
- What balance of store types (SAM'S CLUB vs. Wal-Mart) are you targeting?
- What is the company's future international strategy — acquisition or same-store sales growth via increasing product line?
- What changes of labor and benefits will be taking place soon? How will this affect the company's cost structure?

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Question:

Where are 10-Ks and 10-Qs found?

Question:

Please explain why a company might buy back its stock.

Question:

Do you have to manually punch in the numbers, or is there an easier way to download the numbers from the 10-K and the 10-Q?

Question:

Is there a way to know earlier in the year whether a company is experiencing any difficulty moving toward a successful holiday season?

Afterwards, when looking at the 10-Q, what are some things that should be looked at to get deeper indications with what happened as to how they fared during the holiday season?

Question:

Can you talk specifically about how this analysis applies to financial service companies?

Question:

Do you have any advice for looking at a company that has done a lot of acquisition?

Question:

The SEC is putting forth an initiative to present financial statements in XBRL format. To what degree would that help?

To what degree might it reinforce reliance on technology at the expense of getting familiar with the numbers?

Question:

How do the items on the cash flow statement adjust net income to operating income?

How do they get there from the income statement and the balance sheet?

Question:

When writing for a daily newspaper, do the questions for management change if most of the readers don't have business acumen and are not investors but are employees of the company?