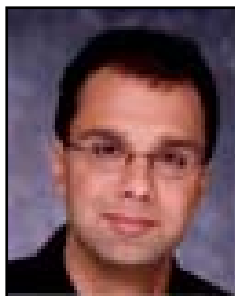


# How to Read and Understand Earnings Releases Like an Investment Pro Case Study: Wal-Mart



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CFA Institute

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[www.cfawebcasts.org](http://www.cfawebcasts.org)

# Webcast Agenda

- Introduction
- Doing Your Homework: Advance Preparation for the Earnings Announcement
- Key Thoughts to Keep in Mind When Reading Earnings News Releases
- Analysis of Wal-Mart's Press Releases Dated 16 August 2005 and 14 November 2005
- Common-Size Statement Analysis for Wal-Mart
- Key Questions to Ask Senior Management
- Follow Up Stories

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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](http://www.marionstreetpress.com) or [www.amazon.com](http://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.

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# Doing Your Homework: Advance Preparation for the Earnings Announcement

1. Study the most recent 10-K report — The press release and company both assume that you “know the business.”
2. At a minimum, read and review the following sections of the 10-K in the following order:
  - Business Overview
  - Products and Services Offered
  - Industry Overview and Competition
  - Management Strategy
  - Cash Flow Statement
  - Balance Sheet
  - Income Statement
  - And last, but most important, Key Risk Factors section on what can hurt the company’s operations, and thus, the stock price. Watch for these factors in the press release.

# Wal-Mart's Key Risk Factors

## From 2005 10-K Report

- 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 From 2005 10-K Report

- 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 Earnings Announcement

3. For more in-depth analysis, maintain a 12-quarter (or longer) rolling history of the Income Statement, Balance Sheet, and Cash Flow Statement from prior filings in an Excel spreadsheet.
  - **Look for trends the press release may not highlight**
  - **Caveat:** It is recommended to review the Cash Flow Statement before the Income Statement and Balance Sheet on the press release because this is what pays the bills – and keeps the company solvent.
  - **But in many cases, the Cash Flow Statement is not “released”** – only the Income Statement and Balance Sheet are provided.
  - In Wal-Mart’s press release, a Cash Flow Statement was provided, but for our exercise, we will get practice without it – and provide the Cash Flow Statement as part of our **Sequel Session called “Buried Treasure in a 10-K and 10-Q”**.  
*(This Session is more number-intensive and requires more time to explain – as we will be showing more “detailed” spreadsheets.)*

# Doing Your Homework: Advance Preparation for the Earnings Announcement

4. Take the 12-quarter rolling history of the Income Statement 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 Total Revenue for the 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.
  - Compare current-year quarter to previous-year quarter – to eliminate seasonality effects.

# Doing Your Homework: Advance Preparation for the Earnings Announcement

## INCOME STATEMENT

	3 months ended		6 months ended	
	7/31/05	7/31/04	7/31/05	7/31/04
Wal-Mart Stores	51,809	46,914	99,449	90,485
Sam's Club Stores	9,969	9,416	19,124	18,057
International	15,033	13,392	29,145	25,943
Other Income	709	737	1,480	1,408
<b>Total Revenue</b>	<b>77,520</b>	<b>70,459</b>	<b>149,198</b>	<b>135,893</b>
Cost of Sales	58,787	53,533	113,357	103,503
<b>Gross Margin</b>	<b>18,733</b>	<b>16,926</b>	<b>35,841</b>	<b>32,390</b>
Operating Costs	14,054	12,522	27,221	24,382
<b>Operating Income</b>	<b>4,679</b>	<b>4,404</b>	<b>8,620</b>	<b>8,008</b>
Net Interest Expense	302	239	502	447
<b>Taxable Income</b>	<b>4,377</b>	<b>4,165</b>	<b>8,118</b>	<b>7,561</b>
Income Tax Expense	1,503	1,458	2,715	2,646
<b>Net Income *</b>	<b>2,874</b>	<b>2,707</b>	<b>5,403</b>	<b>4,915</b>

## COMMON-SIZE INCOME STATEMENT

	3 months ended		6 months ended	
	7/31/05	7/31/04	7/31/05	7/31/04
Wal-Mart Stores	66.8%	66.6%	66.7%	66.6%
Sam's Club Stores	12.9%	13.4%	12.8%	13.3%
International	19.4%	19.0%	19.5%	19.1%
Other Income	0.9%	1.0%	1.0%	1.0%
<b>Total Revenue</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Cost of Sales	75.8%	76.0%	76.0%	76.2%
<b>Gross Margin</b>	<b>24.2%</b>	<b>24.0%</b>	<b>24.0%</b>	<b>23.8%</b>
Operating Costs	18.1%	17.8%	18.2%	17.9%
<b>Operating Income</b>	<b>6.0%</b>	<b>6.3%</b>	<b>5.8%</b>	<b>5.9%</b>
Net Interest Expense	0.4%	0.3%	0.3%	0.3%
<b>Taxable Income</b>	<b>5.6%</b>	<b>5.9%</b>	<b>5.4%</b>	<b>5.6%</b>
Income Tax Expense	1.9%	2.1%	1.8%	1.9%
<b>Net Income *</b>	<b>3.7%</b>	<b>3.8%</b>	<b>3.6%</b>	<b>3.6%</b>

\* Net Income is before Minority Interest. The number is small and less of an issue for this case study presentation.

# Doing Your Homework: Advance Preparation for the Earnings Announcement

5. Take the 12-quarter rolling history of the 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 Total Assets – so that accounts receivable, inventory, and debt levels can be monitored – *another strong measure of asset utilization, indebtedness, and the success of management strategies.*
  - Compare current-year quarter to previous-year quarter – to eliminate seasonality effects.

# Doing Your Homework: Advance Preparation for the Earnings Announcement

## BALANCE SHEET—ASSETS

Year-Ended	7/31/04	1/31/05	7/31/05
Cash and Equivalents	4,709	5,488	5,673
Accounts Receivable	1,280	1,715	1,682
Inventories	28,266	29,762	30,918
Prepaid Expenses/Other	1,585	1,841	2,120
<b>Total Current Assets</b>	<b>35,840</b>	<b>38,806</b>	<b>40,393</b>
Prop, Plant, & Equipment	77,342	84,066	88,979
Less: Accum Depreciation	17,478	18,637	20,369
<b>Net Prop, Plant, &amp; Equipment</b>	<b>59,864</b>	<b>65,429</b>	<b>68,610</b>
Capital Leased Property	2,651	2,718	3,029
Goodwill	10,124	10,803	10,413
Other Assets	2,303	2,427	2,320
<b>Total Assets</b>	<b>110,782</b>	<b>120,183</b>	<b>124,765</b>

## COMMON-SIZE BALANCE SHEET—ASSETS

Year-Ended	7/31/04	1/31/05	7/31/05
Cash and Equivalents	4.3%	4.6%	4.5%
Accounts Receivable	1.2%	1.4%	1.3%
Inventories	25.5%	24.8%	24.8%
Prepaid Expenses/Other	1.4%	1.5%	1.7%
<b>Total Current Assets</b>	<b>32.4%</b>	<b>32.3%</b>	<b>32.4%</b>
<b>Prop, Plant, &amp; Equipment</b>	<b>69.8%</b>	<b>69.9%</b>	<b>71.3%</b>
Less: Accum Depreciation	15.8%	15.5%	16.3%
<b>Net Prop, Plant, &amp; Equipment</b>	<b>54.0%</b>	<b>54.4%</b>	<b>55.0%</b>
Capital Leased Property	2.4%	2.3%	2.4%
Goodwill	9.1%	9.0%	8.3%
Other Assets	2.1%	2.0%	1.9%
<b>Total Assets</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

# Doing Your Homework: Advance Preparation for the Earnings Announcement

## BALANCE SHEET—LIAB + EQUITY

Year-Ended	7/31/04	1/31/05	7/31/05
Commercial Paper	6,827	3,812	9,054
Accounts Payable	19,771	21,987	22,624
Dividends Payable	1,088	0	1,269
Accrued Liabilities	10,825	12,149	11,884
Accrued Income Taxes	637	1,281	1,021
Long Term Debt < 1 Year	4,415	3,759	3,080
Capital Lease Debt < 1 Year	202	223	233
<b>Total Current Liabilities</b>	<b>43,765</b>	<b>43,211</b>	<b>49,165</b>
Long Term Debt	17,044	20,087	20,209
Long Term Capital Leases	3,100	3,171	3,499
Other Long Term Obligations	3,506	4,318	4,171
<b>Total Liabilities</b>	<b>67,415</b>	<b>70,787</b>	<b>77,044</b>
Common Stock & Excess Capital	2,643	2,848	2,874
Retained Earnings	39,427	43,854	43,122
Other Equity	1,297	2,694	1,725
<b>Total Shareholders' Equity</b>	<b>43,367</b>	<b>49,396</b>	<b>47,721</b>
<b>Total Liabilities + Total Equity</b>	<b>110,782</b>	<b>120,183</b>	<b>124,765</b>

## COMMON-SIZE BALANCE SHEET—LIAB + EQUITY

Year-Ended	7/31/04	1/31/05	7/31/05
<b>Commercial Paper</b>	<b>6.2%</b>	<b>3.2%</b>	<b>7.3%</b>
Accounts Payable	17.8%	18.3%	18.1%
Dividends Payable	1.0%	0.0%	1.0%
Accrued Liabilities	9.8%	10.1%	9.5%
Accrued Income Taxes	0.6%	1.1%	0.8%
Long Term Debt < 1 Year	4.0%	3.1%	2.5%
Capital Lease Debt < 1 Year	0.2%	0.2%	0.2%
<b>Total Current Liabilities</b>	<b>39.5%</b>	<b>36.0%</b>	<b>39.4%</b>
<b>Long Term Debt</b>	<b>15.4%</b>	<b>16.7%</b>	<b>16.2%</b>
Long Term Capital Leases	2.8%	2.6%	2.8%
Other Long Term Obligations	3.2%	3.6%	3.3%
<b>Total Liabilities</b>	<b>60.9%</b>	<b>58.9%</b>	<b>61.8%</b>
Common Stock & Excess Capital	2.4%	2.4%	2.3%
Retained Earnings	35.6%	36.5%	34.6%
Other Equity	1.2%	2.2%	1.4%
<b>Total Shareholders' Equity</b>	<b>39.1%</b>	<b>41.1%</b>	<b>38.2%</b>
<b>Total Liabilities + Total Equity</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Question slides can be found on pages 7 and 8.

# Webcast Agenda

- Introduction
- Doing Your Homework: Advance Preparation for the Earnings Announcement
- **Key Thoughts to Keep in Mind When Reading Earnings News Releases**
  - Analysis of Wal-Mart's Press Releases Dated 16 August 2005 and 14 November 2005
  - Common-Size Statement Analysis for Wal-Mart
  - Key Questions to Ask Senior Management
  - Follow-Up Stories

# Key Thoughts to Keep in Mind When Reading Press Releases

1. The press release focuses on good news and best case scenarios (to the extent possible).
2. Strong emphasis on the Income Statement and earnings per share.
  - Other financial statements – Balance Sheet and Cash Flow Statement – typically are issued later, without fanfare, in the 10-Q and 10-K filing.
  - Net income is an easily manipulated figure. Lots of room for gaming.
  - Many “smart money players” consider cash flow to be a better indicator of corporate health than net income.

# Key Thoughts to Keep in Mind When Reading Press Releases

## 3. Earnings news releases are not mandatory.

- Companies are not required by regulators to issue earnings press releases. Thus, they can provide some information but not all.
- Whatever information the company includes in the press release must be true and accurate – but it doesn't need to be “complete” (although revenue and net income figures, if reported at all, must be reported according to GAAP, not pro forma).
- *(Actually, Regulation G that covers earnings releases allows companies to report pro forma earnings or cash flow measures. HOWEVER, if they do that they have to reconcile to the relevant GAAP numbers, e.g., net income for pro forma earnings or operating cash flows for a cash flow proxy like EBITDA.)*
- Required disclosures – the more complete picture is in the 10-Q and 10-K filings and footnotes, which come out two to three weeks after.

# Key Thoughts to Keep in Mind When Reading Press Releases

4. Earnings analysis/news coverage is only half done if you only analyze and report on the press release or Income Statement.
  - The real story may be in the 10-Q and 10-K filing that will be posted (at [www.sec.gov](http://www.sec.gov)) two or three weeks later.
  - Follow the money: Net income (the “bottom line”) from the Income Statement is the “top line” of the Cash Flow Statement – which tells more of the “story” of the company’s true financial position.

# Key Thoughts to Keep in Mind When Reading Press Releases

## 5. Read with healthy skepticism.

- Ask, “Why are they emphasizing these numbers and not others?”
- Don’t be distracted by pro forma calculations and one-time charges.
  - One-time charges are oftentimes recurring, and may reflect a risk of the company that needs to be addressed in analysis/news coverage.
  - If the one-time charges are recurring, they shouldn’t be treated as one-time, but as regular operating items.

# Key Thoughts to Keep in Mind When Reading Press Releases

6. Ask yourself, “What strategies are being implemented to either improve top-line (revenue) growth or increase operating efficiency, and thus, net income (the bottom line)?”
7. Draw conclusions and ask questions based on cause, not effect.
  - Ask why a certain outcome occurred and don’t stop until you get a clear-cut answer that relates to the company’s strategy.
  - Enough of blaming everything on Katrina – in many cases this is an excuse like “dog eating my homework” – Katrina is not a strategy of the company.

[This slide was skipped during the live presentation.]

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# Analysis of Wal-Mart's Press Release Dated 16 August 2005

## Wal-Mart Reports Record Second Quarter Sales and Earnings

- BENTONVILLE, Ark., August 16, 2005 -- Wal-Mart Stores, Inc. reported record second quarter sales and earnings for the quarter ended July 31, 2005. Net sales were \$76.8 billion, an increase of 10.2 percent over the second quarter of fiscal 2005. Net income for the quarter was \$2.8 billion, an increase of 5.8 percent from \$2.7 billion in the second quarter of fiscal 2005. Earnings per share were \$0.67, up from \$0.62 per share in the same prior year quarter.
- Net sales for the six months ended July 31, 2005, were \$147.7 billion, an increase of 9.8 percent over the first six months of fiscal 2005.
- Net income for the six months ended July 31, 2005, increased 9.3 percent to a record \$5.3 billion, up from \$4.8 billion in the same prior year period.
- Diluted earnings per share for the six months ended July 31, 2005, were \$1.25, up from \$1.12 in the same prior year period. Net income for the six months ended July 31, 2005, was favorably impacted by two items totaling \$145 million after tax or \$0.03 per share: an increase due to favorable tax resolutions of \$77 million and positive legal developments of \$68 million after tax.

# Analysis of Wal-Mart's Press Release

## Dated 14 November 2005

### Wal-Mart Reports Record Third Quarter Sales and Earnings

- BENTONVILLE, Ark., Nov. 14 /PRNewswire-FirstCall/ -- Wal-Mart Stores, Inc. (NYSE: WMT) reported record third quarter sales and earnings for the quarter ended October 31, 2005. Net sales were \$75.4 billion, an increase of 10.1 percent over the third quarter of fiscal 2005. Net income for the quarter was \$2.4 billion, an increase of 3.8 percent from \$2.3 billion in the third quarter of fiscal 2005. Earnings per share were \$0.57, up from \$0.54 per share in the same prior year quarter.
- Net income for the quarter ended October 31, 2005, included three items netting to an unfavorable after-tax impact of \$80 million or \$0.02 per share: approximately \$40 million of costs incurred as a result of hurricanes Katrina, Rita, and Wilma; and in our Wal-Mart Stores segment, \$69 million of expense related to product warranty programs partially offset by \$29 million of other income resulting from the Visa MasterCard antitrust litigation settlement.
- Net sales for the nine months ended October 31, 2005, were \$223.2 billion, an increase of 9.9 percent over the first nine months of fiscal 2005.
- Net income for the nine months ended October 31, 2005, increased 7.6 percent to a record \$7.6 billion, up from \$7.1 billion in the same prior year period. Diluted earnings per share for the nine months ended October 31, 2005, were \$1.82, up from \$1.66 in the same prior year period.

# Analysis of Wal-Mart's Press Releases

Lee Scott, President and CEO, said on 16 August 2005,

- "I am proud that the hard work of our associates allowed us to report another record quarter. Early in the quarter, our results were disappointing; however, July came in stronger than expected. Wal-Mart Stores did miss their plan as our customer continues to be impacted by higher gas prices, and it is difficult to improve our expense leverage in the current environment."

Lee Scott, President and CEO, said on 14 November 2005,

- "I am proud of the record results our associates achieved in the quarter while leading the relief efforts in the aftermath of three major hurricanes."

# Analysis of Wal-Mart's Press Releases

## Conclusions –

- Sales up, but net income up by less than sales growth change
- Means declining margins, due to high competition
- Higher 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)

# Analysis of Wal-Mart's Press Release Dated 16 August 2005

5. Wal-Mart Stores segment:  
For the second quarter of fiscal 2006, the Wal-Mart Stores segment, including Supercenters, had segment operating income (income before net interest expense, income taxes, unallocated corporate overhead, and minority interest) of \$3.992 billion, an increase of 8.3 percent, compared with \$3.685 billion in the second quarter of fiscal 2005.
6. For the six months ended July 31, 2005, the Wal-Mart Stores segment, including Supercenters, had segment operating income of \$7.298 billion, an increase of 7.2 percent, as compared with segment operating income of \$6.806 billion in the similar period in the prior year.

# Analysis of Wal-Mart's Press Release

Dated 16 August 2005

7. SAM'S CLUB segment:  
The SAM'S CLUB segment had segment operating income for the second quarter of fiscal 2006 of \$371 million, an increase of 5.4 percent, compared with \$352 million in the second quarter of fiscal 2005.
8. For the six months ended July 31, 2005, the SAM'S CLUB segment had segment operating income of \$666 million, an increase of 7.6 percent, as compared with segment operating income of \$619 million in the similar period in the prior year.
9. International segment:  
The international segment had segment operating income of \$750 million for the most recent quarter, an increase of 0.3 percent, compared with \$748 million in the second quarter of fiscal 2005. The international segment's operating income in the second quarter of fiscal 2006 was impacted by a nonrecurring charge of \$36 million to restructure our operations in the United Kingdom.
10. The International segment had segment operating income of \$1.417 billion for the first six months of fiscal 2006, an increase of 8.1 percent, compared with \$1.311 billion for the similar period in fiscal 2005.

# Conclusions Reaffirm Key Risk Factors

- International markets are just as highly competitive – e.g., Tesco in The United Kingdom.
- Competition has recognized the Wal-Mart margin effect and has responded with price reductions to protect their market share.
- Peer competitors (such as K-Mart and Target) have added “higher value” product lines as Wal-Mart has – such as food and furniture – reducing potential for higher margins for Wal-Mart.
- Risks exist for higher labor costs and less favorable labor relations (unionization).

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# Common-Size Income Statement Analysis of Wal-Mart

## INCOME STATEMENT

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	7/31/05	7/31/04	7/31/05	7/31/04
Wal-Mart Stores	51,809	46,914	99,449	90,485
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Cost of Sales	58,787	53,533	113,357	103,503
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<b>Taxable Income</b>	<b>4,377</b>	<b>4,165</b>	<b>8,118</b>	<b>7,561</b>
Income Tax Expense	1,503	1,458	2,715	2,646
<b>Net Income *</b>	<b>2,874</b>	<b>2,707</b>	<b>5,403</b>	<b>4,915</b>

## COMMON-SIZE INCOME STATEMENT

	3 months ended		6 months ended	
	7/31/05	7/31/04	7/31/05	7/31/04
Wal-Mart Stores	66.8%	66.6%	66.7%	66.6%
Sam's Club Stores	12.9%	13.4%	12.8%	13.3%
International	19.4%	19.0%	19.5%	19.1%
Other Income	0.9%	1.0%	1.0%	1.0%
<b>Total Revenue</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Cost of Sales	75.8%	76.0%	76.0%	76.2%
<b>Gross Margin</b>	<b>24.2%</b>	<b>24.0%</b>	<b>24.0%</b>	<b>23.8%</b>
Operating Costs	18.1%	17.8%	18.2%	17.9%
<b>Operating Income</b>	<b>6.0%</b>	<b>6.3%</b>	<b>5.8%</b>	<b>5.9%</b>
Net Interest Expense	0.4%	0.3%	0.3%	0.3%
<b>Taxable Income</b>	<b>5.6%</b>	<b>5.9%</b>	<b>5.4%</b>	<b>5.6%</b>
Income Tax Expense	1.9%	2.1%	1.8%	1.9%
<b>Net Income *</b>	<b>3.7%</b>	<b>3.8%</b>	<b>3.6%</b>	<b>3.6%</b>

\*Net Income is before Minority Interest. The number is small and less of an issue for this case study presentation.

# Common-Size Balance Sheet Analysis of Wal-Mart

## BALANCE SHEET—ASSETS

Year-Ended	7/31/03	7/31/04	7/31/05
Cash and Equivalents	5,488	4,709	5,673
Accounts Receivable	1,715	1,280	1,682
Inventories	29,762	28,266	30,918
Prepaid Expenses/Other	1,841	1,585	2,120
<b>Total Current Assets</b>	<b>38,806</b>	<b>35,840</b>	<b>40,393</b>
Prop, Plant, & Equipment	84,066	77,342	88,979
Less: Accum Depreciation	18,637	17,478	20,369
<b>Net Prop, Plant, &amp; Equipment</b>	<b>65,429</b>	<b>59,864</b>	<b>68,610</b>
Capital Leased Property	2,718	2,651	3,029
Goodwill	10,803	10,124	10,413
Other Assets	2,427	2,303	2,320
<b>Total Assets</b>	<b>120,183</b>	<b>110,782</b>	<b>124,765</b>

## COMMON-SIZE BALANCE SHEET—ASSETS

Year-Ended	7/31/03	7/31/04	7/31/05
Cash and Equivalents	4.6%	4.3%	4.5%
Accounts Receivable	1.4%	1.2%	1.3%
Inventories	24.8%	25.5%	24.8%
Prepaid Expenses/Other	1.5%	1.4%	1.7%
<b>Total Current Assets</b>	<b>32.3%</b>	<b>32.4%</b>	<b>32.4%</b>
<b>Prop, Plant, &amp; Equipment</b>	<b>69.9%</b>	<b>69.8%</b>	<b>71.3%</b>
Less: Accum Depreciation	15.5%	15.8%	16.3%
<b>Net Prop, Plant, &amp; Equipment</b>	<b>54.4%</b>	<b>54.0%</b>	<b>55.0%</b>
Capital Leased Property	2.3%	2.4%	2.4%
Goodwill	9.0%	9.1%	8.3%
Other Assets	2.0%	2.1%	1.9%
<b>Total Assets</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

# Common-Size Balance Sheet Analysis of Wal-Mart

## BALANCE SHEET—LIAB + EQUITY

Year-Ended	7/31/03	7/31/04	7/31/05
Commercial Paper	3,812	6,827	9,054
Accounts Payable	21,987	19,771	22,624
Dividends Payable	0	1,088	1,269
Accrued Liabilities	12,149	10,825	11,884
Accrued Income Taxes	1,281	637	1,021
Long Term Debt < 1 Year	3,759	4,415	3,080
Capital Lease Debt < 1 Year	223	202	233
<b>Total Current Liabilities</b>	<b>43,211</b>	<b>43,765</b>	<b>49,165</b>
Long Term Debt	20,087	17,044	20,209
Long Term Capital Leases	3,171	3,100	3,499
Other Long Term Obligations	4,318	3,506	4,171
<b>Total Liabilities</b>	<b>70,787</b>	<b>67,415</b>	<b>77,044</b>
Common Stock & Excess Capital	2,848	2,643	2,874
Retained Earnings	43,854	39,427	43,122
Other Equity	2,694	1,297	1,725
<b>Total Shareholders' Equity</b>	<b>49,396</b>	<b>43,367</b>	<b>47,721</b>
<b>Total Liabilities + Total Equity</b>	<b>120,183</b>	<b>110,782</b>	<b>124,765</b>

## COMMON-SIZE BALANCE SHEET—LIAB + EQUITY

Year-Ended	7/31/03	7/31/04	7/31/05
<b>Commercial Paper</b>	<b>3.2%</b>	<b>6.2%</b>	<b>7.3%</b>
Accounts Payable	18.3%	17.8%	18.1%
Dividends Payable	0.0%	1.0%	1.0%
Accrued Liabilities	10.1%	9.8%	9.5%
Accrued Income Taxes	1.1%	0.6%	0.8%
Long Term Debt < 1 Year	3.1%	4.0%	2.5%
Capital Lease Debt < 1 Year	0.2%	0.2%	0.2%
<b>Total Current Liabilities</b>	<b>36.0%</b>	<b>39.5%</b>	<b>39.4%</b>
<b>Long Term Debt</b>	<b>16.7%</b>	<b>15.4%</b>	<b>16.2%</b>
Long Term Capital Leases	2.6%	2.8%	2.8%
Other Long Term Obligations	3.6%	3.2%	3.3%
<b>Total Liabilities</b>	<b>58.9%</b>	<b>60.9%</b>	<b>61.8%</b>
Common Stock & Excess Capital	2.4%	2.4%	2.3%
Retained Earnings	36.5%	35.6%	34.6%
Other Equity	2.2%	1.2%	1.4%
<b>Total Shareholders' Equity</b>	<b>41.1%</b>	<b>39.1%</b>	<b>38.2%</b>
<b>Total Liabilities + Total Equity</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

# Common-Size Conclusions of Wal-Mart

- Higher increases in new Property, Plant, and Equipment (say stores in this case) may not provide incrementally higher margins and thus cash flow.
- Debt levels have been rising at the same rate of new stores and store conversions to supercenters – not sure how much more profit Wal-Mart can gain from this (or is it merely to protect market share?).
- Growth in sales, net income will always be record (this word is overused in every press release – how many times will be it record in the future?) – but will it be beneficial to the shareholder in terms of cash flow?

# Webcast Agenda

- Introduction
- Doing Your Homework: Advance Preparation for the Earnings Announcement
- Key Thoughts to Keep in Mind When Reading Earnings News Releases
- Analysis of Wal-Mart's Press Releases Dated 16 August 2005 and 14 November 2005
- Common-Size Statement Analysis for Wal-Mart
- **Key Questions to Ask Senior Management**
- Follow-Up Stories

# Key Questions for Senior Management

- What does Wal-Mart plan on doing to protect market share? Is management's strategy merely based on lower, competitive pricing?
- What product differentiation strategies does Wal-Mart have in its pipeline of new introductions?
- What cost reduction strategies does the company have in its future?
- What is Wal-Mart's strategy for dealing with potentially higher labor costs (e.g. employee turnover, potential for unionization, labor benefits)? This would relate to a potentially higher cost structure but also maybe lower employee turnover.
- What effect is store rebuilding, e.g., supercenter replacements for discount stores, and new store development having versus same-store profitability? For example, what is the sales/square foot in same stores (existing stores) compared to new stores?

Question slides can be found on pages 7 and 8.

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# Follow Up Stories

- Watch for the 10-Q and 10-K filing two to three weeks after the press release.
- Read the filing, especially the footnotes.
- Look deeper into the historical financials and Cash Flow Statement on the true “mechanics” of the company’s operations.
- For more on this + Cash Flow Statement analysis, join us for our sequel media webcast to start the year 2006 off right!:

“Buried Treasure in a 10-K and 10-Q”

on Tuesday, January 10, 2006, at 12:00 noon Eastern Time.

## **Question:**

What questions should be composed when reviewing the earnings announcement numbers?

## **Question:**

When you have analyzed the press release, how can you verify the trends you outlined? Can you do more in-depth probing on the trends when the 10-Q comes out?

## **Question:**

Does the ratio between equity and debt liability seem disproportionately high for a company like Wal-Mart?

## Question:

Is 24.8 percent an excessively high amount of inventory liability?

## **Question:**

Please explain the percentage conversion in the common size statement?

## **Question:**

What are the implications of the financial restatements in 2004 and 2005?

## **Question:**

Is there any software available to do the analysis that you have mentioned?

## Question:

What changes do you account for when looking at a bank's financial statements? What adjustments have to be made? When looking at 10-Qs online, what keywords do you search for?

## **Question:**

Which line items in a press release should be compared to obtain a meaningful ratio?

## **Question:**

What would you look for that may be wrong in a press release (e.g., one-time cost with a bank, fines, theft, identity theft, etc.)?