Acquisition of the fresh market by wal-mart stores term paper sample

Business, Company

Executive Summary

Wal-Mart Stores Incorporation boasts of market leadership in the provision of retail products and services to clients located across the globe. According to Walmart (2013), the retailer relies upon its 10, 900 retail units spread across 27 countries to increase its share of the retail market. The retailer, listed on the New York Stock Exchange, is the largest in the United States of America. Essentially, the company provides all products under a single roof. This ability appeals to customers who have limited time to shop around for consumer and commercial products.

The company has grown its internal operations to such levels that any additional organic expansion would not only be ineffective but could pose adverse impacts on the company's profitability. Moreover, organic growth, the office realised, would soar up the expenses incurred by the business. The expansive business would impose management challenges. In the light of this fact, the top management of the business proposed acquisitions and mergers as the best ways to internationalise Wal-Mart's operations. The top management proposed The Fresh Market as the best target for the proposed acquisition. Consequently, the office of the Chief Corporate Advisor at the Wal-Mart was mandated to analyse the feasibility of the proposed acquisition. This report provides an analysis of the proposed acquisition of the Fresh Market by Wal-Mart Stores Incorporation. To begin with, the department analysed relevant financial information accessed through the Yahoo Finance, academic sources, and company website. The office relied upon the collected information to value The Fresh Market.

Financial Information of The Fresh Market

Howson (2003, pp. 246) advises all predator companies to conduct due diligence on all potential targets for planned acquisitions. This analysis emphasises the evaluation of the financial performance of the target company. Walmart should consider this advice before it makes the decision as to whether or not it should acquire The Fresh Market.

A single accounting data by itself may not communicate any meaningful and useful information, but when expressed in relation to some data, it definitely conveys some significant information to the interested parties. In order to make sense of these figures, companies rely upon ratio analysis. Debarshi (201, pp. 47) describes financial ratios as a relationship between two or more accounting data expressed in mathematical terms. Ratios can be analysed on a three-tier basis. To begin with, ratios can be analysed on the intercompany basis. This basis compares an item on the financial statements within a company in the current year with the same item or relationship in one or more prior years. This tendency to evaluate a series of financial statement data over a period of time is referred to as horizontal analysis. For example, Wal-Mart Stores Incorporation can exercise horizontal ratio analysis by comparing the ratios attained during the current operating year with same ratios relating to past operating years. Importantly, horizontal analysis enables a company to monitor the effectiveness of all strategic decisions made by its management of the target company. The analysis further reveals any favourable or unfavourable trends in the company's performance. Whereas an increase in sales revenue is admirable, an increase in long-term debt is undesirable since it implies increased interest

expenses. Second, organizations can compare financial items or ratios with industry averages or norms published by financial ratings. For example, Wal-Mart Stores Incorporation can compare The Fresh Market's ratios against those of the retail industry. This analysis can enable the company to assess the latter's financial performance in relation to the industrial figures. Finally, companies can compare items or financial relationship with the same item or relationship in one or more competing companies. This analysis is mostly adopted by potential investors

The Fresh Market has witnessed a dramatic change of its line items. The amount of cash held by the company decreased from $ 10, 681, 000 in 2012 to $ 8, 737, 000 in 2013. As a result of the rapid change, the amount of current assets increased from $ 63, 067, 000 in 2012 to $ 71, 011, 000 in the next year. Even though holding sufficient cash reserves indicates good health, holding excess reserves may be unfavourable. It might imply idle funds which ought to have been invested in other more profitable projects. The company has also acquired additional property, plant and equipment. Despite holding $ 425, 330, 000 during the 2012 financial year, the company reported $ 496, 904, 000 in 2013. By acquiring the new equipment, The Fresh Market Corporation has expanded its capacity to handle considerable amount of supplies and inventory. However, the increase in assets has been accompanied by a slight increase in the company's account payables. The company reported $ 34, 788, 000 and $ 35, 634, 000 as accounts payables during the 2012 and 2013 financial years respectively. The rapid rise in the level of accounts payable reduced the expected high working capital. The amount of cash available to offset short-term loans when they fall due

reduced during the two-year period. The amount of long-term debt has dropped considerably in the same period. The company reported $ 64, 000, 000 in long-term debt during the financial period 2012 before dropping to $ 42, 000, 000. Since the long-term debt attracted high interests, a decrease in their figures led to a reduction in the level of interests paid on debt. The company reported $ 1, 858, 000 in interest expense during the 2012 financial year. The figure later dropped to $ 1, 498, 000 in 2013. A reduction in the interest expense means the company increased shareholder value. Despite maintaining a constant level of common stock, the company has increased the amount of retained earnings from $ 27, 813, 000 in 2012 to $ 91, 946, 000 in the next year, 2013.

The company's revenue has risen during the last three years. The lowest figure, $ 980, 403, 000 was reported in 2011. This figure rose to $ 1, 108, 035, 000 in 2012 before further rising to $ 1, 329, 131, 000 in 2013. This rise could be attributed to the massive marketing campaigns commissioned by the company over the last three years coupled with the investment in property, plant and equipment. The net income from operating activities increased from $ 21, 338, 000 in 2011 to $ 51, 395, 000 in 2012 and further to $ 64, 133, 000 during the 2013 financial year.

Liquidity Analysis

Liquidity refers to the ability of a company to repay its short-term debts whenever they fall due.

Current Ratio(2012) = 63, 067, 000 = 0. 78

81, 142, 000

Current Ratio(2013) = 71, 011, 000 = 0. 79

90, 019, 000

Ideally, businesses should have a current ratio of 2: 1. In its current form, The Fresh Market cannot repay its short-term liabilities whenever they fall due. Even though this was an improvement from 2011, the figure is still lower than the acceptable minimum. The company stands to face liquidity problems in case of eventualities associated with sudden short-term debt repayments.

Quick ratio measures the liquidity of a company in strict sense. Inventory, which is the least liquid asset among the current assets, is excluded for determining the ratio. Current assets minus inventory are the highest liquid assets the firm can own.

Quick Ration (2012) = (63, 067, 000 – 43, 985, 000) = 0. 31

81, 142, 000

Quick Ration (2013) = (71, 011, 000 – 37, 751, 000) = 0. 37

90, 019, 000

Generally, the standard quick ratio is 1: 1. Quick ratio is less than the current ratio, the difference being caused by inventory. Despite quick ratio being a better measure than the current ratio, it does not give the accurate measurement of liquidity. This arises from the fact that some debtors cannot be converted into cash. They would turn into doubtful debts and are eventually written off the company’s books.

Cost of Capital: The Fresh Market

The Fresh Market uses a mix of retained earnings, debt, and share capital to finance its operations. During the latest financial year (Ending January 27, 2013), the company held the following proportions of the three categories of capital.

The long-term debt attracted an average interest rate of 2. 7 % during the financial year 2013 (The Fresh Market, April 2013). The company is subject to a federal tax rate of 35 % (The Fresh Market, April 2013, pp. 85). This rate must be considered in determining the cost of capital employed by the company.

The cost of retained earnings is the required rate of return on equity (Sheeba 2011, pp. 278). Retained earnings are the earnings left after deducting dividend payments and other provisions from profit after tax. Thus, retained earnings are the net amount left with the firm after paying all its liabilities and obligations including equity dividends. In most circumstances, the cost of retained earnings is less than the cost of equity. This difference arises from the existence of the equity issuance costs during the issue of equity through the stock market. However, The Fresh Market's costs of equity and retained earnings are equal. This fact arises from the fact that the company incurred no cost was incurred in the issuance of additional equity during the year which ended on 27 January 2013 (The Fresh Market, April 2013, pp, 51).

The cost of equity can be computed from the Price/Earnings ratio as follows (Sheeba 2011, pp. 277):

Cost of Equity = (1 ÷P/E) or Ei/P where Ei is the expected earnings per share for the next year and can be calculated as (Current earnings per share) X (1

+ growth rate of earnings per share). The Earnings Per Share(2013) amounted to $ 1. 33 per share (The Fresh Market, April 2013). The average market price of the company's shares on 18 September 2013 is $ 49. 82 per share (Yahoo Finance, 18 September 2013). During the 2013 financial year, the Earnings Per Share grew by ($ 1. 33 – $ 1. 07)/1. 07 = 15. 3 %.

Assuming a constant growth of Earnings Per Share, the cost of equity would be: 1. 33 (1+0. 153)/49. 82 = 1. 153/49. 82 = 2. 3 %.

Since the company uses a mix of different forms of capital to finance its operations, the office used the Weighted Average Cost of Capital to determine the average cost. This was done as follows:

Brigham & Daves (2012, pp. 360) observe the necessity to use the after-tax component of debt in the computation; after tax cost of debt = 2. 7 % (1 – 0. 35) = 2. 7 %*0. 65 = 1. 755 %

The Weighted Average Cos Capital = Ke*E + Kd*D

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Value of The Fresh Market

The Fresh Market has a market capitalisation of $ 2. 41 Billion. This figure is slight above the total shareholders' equity which stands at $ 1. 97859 Billion.

Recommendation

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