

Financial analysis of sears vs. wal-mart essay sample

[Finance](#)



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Wal-Mart

Wal-Mart Stores, Inc., incorporated in 1969, is an international retailer. In the United States, the Company operated 1, 568 discount stores, 1, 258 Super centers, 525 SAM's CLUBs and 49 Neighborhood Markets as of January 31, 2003.

Wal-Mart's greatest advantage is having great bargaining power with suppliers to get the lowest price so they can pass it on to the customer. To further this, Wal-Mart is continuing to lower prices, offer newer and up to date products through their global suppliers' sourcing network.

Sears

In 1886 Sears began the R. W. Sears Watch Company in Minneapolis. Sears, Roebuck and Co was officially formed in 1893. Sears is a leading retailer of apparel, home and automotive products and services, with annual revenue of more than \$40 billion. Sears operated 863 mall-based retail stores, most with co-located Sears Auto Centers, and an additional 1, 200 retail locations including hardware, outlet, tire and battery stores as well as independently owned stores, primarily in smaller and rural markets.

The two retailers, Sears, Roebuck and Co. and Wal-Mart Stores, Inc., have a very similar value for return on equity in the recent fiscal years. We are using the past 5 years information to analyze the strategies and accounting policies for each company, and better understand the companies' performance and predict the companies' trend in the future for each firm.

This case provides a good introduction regarding the combination of such information to create a powerful tool for financial statement analysis.

Profitability analysis

Exhibit 1-1 Comparison of profitability ratios

2002 2001 2000 1999 1998

SEARS WMT SEARS WMT SEARS WMT SEARS WMT SEARS WMT

ROS 3. 3% 3. 06% 1. 79% 3. 29% 3. 29% 3. 26% 3. 69% 3. 22% 2. 63% 2. 99%

Gross margin 44. 0% 22. 2% 41. 3% 22. 5% 38. 2% 22. 5% 39. 4% 22. 2% 38. 3% 21. 9%

operating profit/sale 5. 9% 4. 9% 3. 0% 5. 3% 5. 4% 5. 5% 6. 1% 5. 2% 4. 7% 4. 9%

EBIT/sales 8. 7% 5. 6% 6. 4% 6. 1% 8. 5% 6. 2% 9. 4% 5. 8% 8. 3% 5. 5%

EBITDA/sales 10. 8% 6. 8% 8. 5% 7. 3% 10. 6% 7. 4% 11. 5% 7. 2% 10. 4% 6. 9%

Return on sales

ROS ratio compares after tax profit to sales, it displays the proportion of each dollar of revenue is available for the owners after all the expenses are paid to other suppliers. ROS can help us determine if companies are making enough of a return on sales effort. From the exhibit 1-1, it shows that though <https://assignbuster.com/financial-analysis-of-sears-vs-wal-mart-essay-sample/>

the year 1998 Wal-Mart is higher than Sears. But from fiscal year 1999, Sears had caught up with Wal-Mart. In 2001 Sears dropped to 1.79% from 3.29% and comparing with Wal-Mart's 3.29, that's because in 2001 Sears began reviewing product offerings in an effort to remove unprofitable merchandise offering as well as eliminate merchandise lines that were not relevant to Sears' customers. Sears undertook a repositioning of full-line store, resulting in an increase in the overall profitability in 2002. From view of Wal-Mart, the growing steadily but lower than Sears, that's because profitability of Wal-Mart depends on their competitive situation.

Gross Margin

The gross profit margin ratio indicates how efficiently a business is using its materials and labor in the product process. It shows the percentage of net sales remaining after subtracting cost of goods sold. A higher gross profit margin indicates that a business can make a reasonable profit on sales, as long as it keeps overhead cost in control. A low margin could indicate companies are underpricing. A high margin could indicate overpricing if business is slow and profits are weak. Comparing Sears with Wal-Mart, Sears is higher than Wal-Mart since 1998, it means Sears well controlled than Wal-Mart in costs and expenses. But Wal-Mart has a lower gross margin that is because Wal-Mart believes in higher volume and low mark-ups.

Operating profit/sales

Operating profit is for a certain period divided by revenues for that period. Operating profit margin indicates how effective company is at controlling the

costs and expenses associated with their normal business operating. Refer the exhibit 1-1,

We can observe that Wal-Mart and Sears performed the costs and expenses controlling effectively almost in average situations. However, Wal-Mart has a little bit higher than Sears in 1998. But Sears had caught up in 1999 and still growing up in 2002.

EBIT/sales

EBIT is a measure of company's earning power from ongoing operations, equal to earnings before deduction of interest payments and income taxes. EBIT ratio is examined for how profitably a company produces and markets its goods, particularly useful for those determining whether a company can pay its interest expense and with what degree of safety. Comparing with operating profit/sales ratio, it implied the interest expenses had more impact on Sears' operation than Wal-Mart.

EBITDA/sales

EBITDA is a good measure and widely to use to evaluate the core profit trends. This ratio can be used to evaluate the profit potential between companies because it eliminates some of the extraneous factors and all the outside influences and timing effects on the company's profitability figure. Refer the exhibit, we can find that Sears' cash earning increase was higher than Wal-Mart.

Asset Utilization Analysis

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Exhibit 1-2 Comparison of asset utilization ratios

2002 2001 2000 1999 1998

SEARS WMK SEARS WMT SEARS WMT SEARS WMT SEARS WMT

TATO 0. 87 2. 69 1. 01 2. 58 1. 07 2. 74 1. 07 2. 89 1. 06 2. 60

ROA 2. 9% 8. 3% 1. 8% 8. 5% 3. 6% 8. 9% 3. 9% 9. 3% 2. 8% 7. 8%

inventory turnover 5. 01 7. 59 5. 34 7. 01 4. 74 6. 55 5. 06 6. 37 5. 66 5. 66

day's inventory 72. 8 48. 1 68. 3 52. 1 77. 0 55. 7 72. 2 57. 3 64. 5 64. 5

accounts receivable to net sale 88. 6% 0. 9% 80. 6% 0. 9% 49. 1% 0. 8% 52. 5% 0. 8% 50. 1% 0. 8%

day's sales outstanding 323. 4 3. 3 294. 2 3. 3 179. 2 2. 9 191. 6 2. 9 182. 9 2. 9

accounts payable to purchases 29. 2% 9. 1% 27. 4% 10. 0% 27. 6 10. 1% 27. 3% 9. 4% 24. 7% 9. 8%

payable payment period 106. 6 33. 2 100. 0 36. 5 100. 7 36. 9 99. 6 34. 3 90. 2 35. 8

Asset utilization analysis is to analyze and indicate how effectively or efficiently a company uses its assets.

Total asset turnover

TATO ratio is net sales divided by total assets. This is a measure of how well assets are being used to produce revenue. Total asset turnover is used to indicate a company's degree of operating leverage. A low asset turnover ratio does not indicate a weak corporation. From exhibit 1-2, it shows Wal-Mart is more efficient than Sears to operate performance with its assets - low profit margins and a high asset turnover in the past years. But for Sears, the lower asset turnover can still generate significant profits with high profit margins.

Return on assets

With further relating to TATO and ROS, by multiplying TATO by ROS, we can gain the return on assets (ROA). By understanding this relationship, we can find the capital-intensive companies have lower returns on assets than service companies with fewer assets. Comparing with Sears and Wal-Mart in fiscal years, it displays that Wal-Mart's ROA is far higher than Sears, it means, Wal-Mart, the higher asset-intensive a business. For Sears, the more asset-intensive a business, the more money must be reinvested into it to continue generating earnings.

Inventory Turnover

Inventory turnover tells how often a business' inventory turns over during the course of the year. For most companies, inventory is a very large asset, a high inventory turnover ratio is generally positive. On the other hand, an unusually high ratio compared to the average for same industry could mean a business is losing sales because of inadequate stock on hand. Comparing

with Seas and Wal-Mart, it showing Wal-Mart has a little bit higher inventory turnover ratio than Sears. It's indicating that Wal-Mart is using its financial resources efficiently by maintaining low inventories.

Days' inventory

The inventory turnover ratio also can be expressed as the number of days goods are kept in inventory. The days' inventory is computed by dividing a company's ending inventory by its cost of sales, and multiplying this result by the number of 365 days. From exhibit 1-2, we can find the days' inventory of Sears is increasing also higher than Wal-Mart. On contrast, Wal-Mart is decreasing its day's inventory. Reviewing the inventory turnover with days' inventory, the trend shows us Wal-Mart is more efficient use of cash.

Account receivable/day's sales outstanding

Account receivable is the sales made for credit for which payment has not been received. The ratio of accounts receivable to net sales indicates the relative proportion of the company's sales made on credit and still outstanding at the end of the reporting period. Comparing with Sears and Wal-Mart, we are surprised for the huge ratio difference between two companies. The reason for Sears has immense proportion of account receivable and average 234.3 day's sales outstanding (still increasing) is because Credit cards have been a big part of Sears business over the years, representing 60%, or 1.5 billion, of the company's annual operating income. As for Wal-Mart, we are also amazing its low ratio of account

receivable with average 3.06 day's sale outstanding. The reason for Wal-Mart is they adopt the Layaway Plan, cash paid for with credit or debit cards.

Accounts payable to purchases/payable payment period

Accounts payable to purchase indicates how much the firm owes to its suppliers in relation to what it purchased from them and how efficient the company manages its short-term liabilities. Companies that use their suppliers as a source of funding will have longer payable payment periods. In exhibit 1-2, we can recognize Sears has longer payment period (still increasing) to its suppliers. But owing to its day's sales outstanding slower than payable payment period, it carries Sears in negative. As for Wal-Mart, its ratio of account payable to purchases payable payment is shorter than Sears, but its payable payment period is longer than its days' sales outstanding, it shows Wal-Mart well perform risk reduced. Shorter time payable payment period also indicates Wal-Mart purchase policy with low cost.

Capitalization Analysis

Assets to Equity

Wal-Mart's Assets to Equity

Year 1998 1999 2000 2001 2002

Assets 45,384 49,996 70,349 78,130 83,451

Shareholder's equity 18,503 21,112 25,834 31,343 35,102

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Assets to equity 2. 45 2. 37 2. 72 2. 49 2. 38

From year 1998-2002 Wal-Mart's total assets and shareholder's equity are increasing annually. The assets to equity ratios are come out from the total assets divide by shareholder's equity. The result came out Wal-Mart's assets to equity is higher than 100%, which mean Wal-Mart finances some of its assets with debt that means during these 5 years, Wal-Mart are borrowing money to invest their company instead of use their own money to invest.

Sears' Assets to Equity

Year 1998 1999 2000 2001 2002

Assets 37675 36954 36899 44317 50409

Shareholder's equity 6066 6839 6769 6119 6753

Assets to equity 6. 21 5. 40 5. 45 7. 24 7. 46

Same as Wal-Mart, Sears' assets of equity are more than 100%. Sears Company is also borrowing money to invest their company, but the average ration is much more than Wal-Mart which means Sears is borrowing much more money to invest the company than Wal-Mart. Also, Sears' assets to equity are increasing from 1999-2002 which is they borrow more and more and invest into the company.

Return on Equity

The fewer assets a company uses to generate sales, and the more debt it uses to finance those assets, holding other things equal, the higher the return shareholders can earn.

Wal-Mart's ROE

Year 1998 1999 2000 2001 2002

Net income 3526 4430 5377 6295 6671

Equity 18, 503 21, 112 25, 834 31, 343 35, 102

ROE(%) 19 21 20 20 19

Sears' ROE

Year 1998 1999 2000 2001 2002

Net Income 1048 1453 1343 735 1376

Equity 6066 6839 6769 6119 6753

ROE(%) 17 21 20 12 20

These two companies are representing both of company with fewer assets and higher assets. The net income tells us that Wal-Mart is the higher one which uses more debt it uses to finance assets. Zeller is the fewer assets company. Although these two companies has different assets, the ROE comes out almost the same that means although Sears has fewer net income than Wal-Mart, but they still can have same profit as Wal-Mart. In the year

2001, Sears' net income drop almost 50% to only 735 million and that makes the ROE drop to only 12%.

Although these two companies have almost the same ROE, but If I am an investor, I would like to invest Wal-Mart. The reason for choosing Wal-Mart is Wal-Mart's is more stable than Sears, the net income increase annually and stably.

Marketing ratios analysis

Wal-Mart

2002 2001 2000 1999 1998

earnings per share 1. 49 1. 40 1. 20 0. 99 0. 78

PE ration 37. 70 37. 04 43. 10 45. 15 20. 37

dividend yield 0. 5% 0. 5% 0. 4% 0. 4% 0. 9%

Sears

2002 2001 2000 1999 1998

earnings per share 4. 29 2. 24 3. 88 3. 81 2. 68

PE ration 9. 85 16. 81 7. 48 10. 55 16. 34

dividend yield 2. 2% 2. 4% 3. 2% 2. 3% 2. 1%

From the chart, we can know that the earning per share of Wal-Mart is risen from 0. 78 in1998 to 1. 49 in 2002. The earning per share of sears didn't

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have rules. From 1998 to 2002, the highest is 4.29 in 2002, the lowest is 2.24 in 2001. But comparing two companies, it is obviously that sears' earning per share is higher than Wal-Mart. On the other hand, it is obviously that Wal-Mart has high PE ratio in 2002 and 2001, the PE ratio is about 37. In 2000 and 1999, the PE ratio is about 43. The lowest PE ratio is 20 in 1998. Why the PE ration is quickly increase after 1998. I think the reason is the Wal-Mart is quickly growth in its net sales after 1998. In 1999 and 2000 his net sales increased 17% and 20%. So many investors buy Wal-Mart share, his stock price is risen, PE ration is very high. In 2001 and 2002, his sales increase is reduced to 16% and 14%. The investors aren't so hot to his stock. So his price is reduced and PE ratio is reduced. These are only my guess. The Sears PE ration is lower than Wal-Mart's. I can't say which company is better through PE ration. PE ration can tell the company that the market price has overvalue or undervalue, let them decide split or not.

In the dividend yield, we can know Wal-Mart has a lower dividend yield than Sears. We all know that the company didn't pay high dividend has several reasons. One is it need money to continue investment. Second is it didn't earn enough money, if it paid high dividend it will can't continue his business. The third reason is the shareholder won't pay much income tax, so they didn't need high dividend. So we can guess the sears is stable in his business and net income, it didn't need so much net income keep in his account, at the same time it's shareholder want dividend to invest other project. But Wal-Mart is more active, it wants to open new market, so it keeps enough money to investment.

WACC Analysis- Weighted Average Cost of Capital Why Use WACC?

Corporations create value for shareholders by earning a return on the invested capital that is above the cost of that capital. WACC (Weighted Average Cost of Capital) is an expression of this cost and is used to see if certain intended investments or strategies or projects or purchases are worthwhile to undertake. WACC is expressed as a percentage, like interest. So for example if a company works with a WACC of 12%, than this means that only (and all) investments should be made that give a return higher than the WACC of 12%. The cost of capital for any investment, whether for an entire company or for a project, is the rate of return capital providers would expect to receive if they would invest their capital elsewhere. In other words, the cost of capital is an opportunity cost. How can the Weighted Average Cost of Capital (WACC) be calculated?

The Weighted-Average Cost of Capital Method is a modern method of valuing a company. WACC can expect average of future costs of funds over the long run; expected return on all of the company's securities. The model is concerned with the return on assets to maintain the current stock price, especially when we used the market value capital structure. The book value capital structure could not reflect current market or company conditions. When we use the WACC, a lower WACC implies that the firm must see a lower return on assets to maintain stock price. $WACC = [R_d \cdot (1-t) \cdot (D/V)] + [R_e \cdot E/V] + [R_p \cdot P/V] = [\text{cost of debt} \cdot (1-\text{tax rate}) \cdot \text{debt proportion}] + [\text{cost of equity} \cdot \text{proportion of Equity}]$ To estimate the WACC we used four things -

- The marginal Required return on debt
- The marginal Required return on

equity· Tax rate· Proportions of debt and equity in the capital structure

Marginal is the critical word in this analysis.

We cannot use past costs. We are using the returns currently required by lenders and shareholders. 1. Required return on Debt The easy part of WACC is the debt part of it. In most cases it is clear how much a company has to pay their bankers or bondholders for debt finance. More elusive however, is the cost of equity finance. Normally, the cost of equity finance is higher than the cost debt finance, because the cost of equity involves a risk premium. Calculating this risk premium is one thing that makes calculating WACC complicated. How do we find the marginal cost of debt? The company is in the process of borrowing, the marginal cost of debt is obvious, and it is the rate at which lenders say they will lend. If the company is not borrowing, then we have to estimate what cost if it were borrowing. 2. Tax rate The tax rate is important in determining the company's after tax cost of debt, because normally interest payments are tax-deductible. Since this is a forward looking analysis we are interested only in the marginal tax rate, not historic rate.

For a cursory analysis, typically we use the statutory rate, the rate required by law. 3. Required return on equity While calculating WACC there are three ways to calculate the cost of equity, a necessary component of the model. Capital Asset Pricing Model, Dividend Discount Model, and Earnings Capitalization Ratio can all be used to determine a cost of equity for the firm. Each model is considered to have strengths and weaknesses relative to the other segments. CAPM is considered to be the most complete model, taking

into account the firm's beta, the risk-free rate, and the diversified portfolio rate. The Dividend Discount Model compares dividends forecasted for the next period with the current share price for the firm and then adds the growth rate of the firm. Finally, the Equity Capital Model compares forecasted earnings for the next period over the current share price. It is clear why CAPM is the preferred model as DDM and ECR are dependent on the forecasts of dividends or earnings and disregards the impact on the market.

Overall, each model should generate a comparable cost of equity when market performance and forecasts move in a similar direction. 4. The capital structure Finally, we need to estimate the proportions of the debt and equity that will be used to finance the company. We have four choices of capital structure to use in the WACC. Book value capital reported. This is the proportion of debt and equity to total capital reported on the financial statement. This is the cumulative impact of all the company's past financings. The value of debt and equity reflect the values at the time they were initially issued. This capital structure does not reflect current market or company conditions. Market value capital structure. This capital structure represents the weights of debt and equity at their capital market values. This represents the value of past financing in the light of the current market and company conditions. Target capital structure. This capital structure represents management financing policy over the long term.

Its estimate of the company's optimal capital structure. Investor anticipated capital structure. This is the percentages of debt and equity investors believe

will be used to finance the company in the future. But, it is impossible to observe. Another important complication is which mix of debt and equity should be used to maximize shareholder value (This is what "Weighted" means in WACC). Recalculation of WACC: Wal-Mart WACC = $[R_d \cdot (1-t) \cdot (D/V)] + [R_e \cdot E/V] = [\text{Cost of debt} \cdot (1-\text{Tax rate}) \cdot \text{Debt Proportion}] + [\text{Cost of equity} \cdot \text{Proportion of equity}]$

$D = \text{Amount of debt expected in the firm's capital structure} = 48,349$
 $E = \text{Amount of equity expected in the firm's capital structure} = 35,102$
 $V = D + E + P$, the value of the firm's capital = 83,451 ($P = 0$)
 $R_d = \text{Marginal required return on debt} = 9.8\%$
 $R_e = \text{Marginal required return on equity} = 6.53\%$
 $R_e = 1 / (\text{market price} / \text{earning per share}) = 1 / \text{PE ratio} = 1 / (49.94 / 3.26) = 0.0653 = 6.53\%$
 $\text{WACC} = 9.8\% \cdot (1 - 34\%) \cdot 0.579 + 0.0653 \cdot 0.421 = 0.0374 + 0.0275 = 6.49\%$

Recalculation of WACC: Sears WACC = $[R_d \cdot (1-t) \cdot (D/V)] + [R_e \cdot E/V] = [\text{Cost of debt} \cdot (1-\text{Tax rate}) \cdot \text{Debt Proportion}] + [\text{Cost of equity} \cdot \text{Proportion of equity}]$

$D = \text{Amount of debt expected in the firm's capital structure} = 30,637$
 $E = \text{Amount of equity expected in the firm's capital structure} = 6,753$
 $V = D + E + P$, the value of the firm's capital = 30,637 + 6,753 = 37,390 ($P = 0$)
 $R_d = \text{Marginal required return on debt} = 6.75\%$
 $R_e = \text{Marginal required return on equity} = 18.53\%$
 $R_e = 1 / (\text{market price} / \text{earning per share}) = 1 / \text{PE ratio} = 1 / (23.15 / 4.29) = 1 / 5.396 = 18.53\%$
 $\text{WACC} = 6.75\% \cdot (1 - 34.8\%) \cdot 0.82 + 18.53\% \cdot 0.18 = 0.036 + 0.033354 = 6.94\%$

What does this mean? Weighted Average Cost of Capital (WACC) is the required return for an entire firm. Because capital for a firm is raised from multiple sources, the cost of capital must reflect the cost of each source of capital. By weighting the cost of

capital according to the existing finance structure of an organization, a more accurate estimate of cost of capital can be acquired.

I am interested in Wal-Mart's WACC since this is an indicator of future stock price. To Wal-Mart, a lower WACC means that Wal-Mart must have future values perform at a lower rate to maintain stock price. On the other hand, it is the same to the Sears. To Sears, a higher WACC means that the risk of investment to Sears is higher than Wal-Mart. Possibly, the higher investment risk could be higher return. Finally, Wal-Mart could borrow more money with lower WACC than Sears. Wal-Mart free cash flow and Valuation(In millions of dollars)AssumptionsSales growth 14% Debt \$1, 052 Debt/total capital 1.

3%Terminal sales growth 3. 0% Required ROE 19% Sales 2002 \$217,

799Operating expenses 60% Marginal cost of debt 9. 8% WACC 6.

49%Exhibit — Wal-MartIncome Statement changes 2003 2004 2005 2006 2007

Sales \$248290. 9 \$283051. 6 \$322678. 8 \$367853. 8 \$378889. 4

Operating expenses (148974. 54) (169830. 95) (193607. 28) (220712. 28) (227333. 6)

Gross profit 99316. 36 113220. 65 129071. 52 147141. 52 151555. 8

Depreciation (3078) (3508. 9) (4000. 2) (4560. 2) (4697. 0)

Profit before taxes 96238. 4 109711. 75 125071. 32 142581. 32 146858. 8

Taxes (4442. 6) (5064. 5) (5773. 6) (6581. 9) (6779. 4)

Profit after taxes \$91795. 8 \$104647. 3 \$119297. 7 \$135999. 4 \$140079. 4

No cash changes depreciation 3078 3508. 9 4000. 2 4560. 2 4697. 0

Balance sheet change (3078) (3508. 9) (4000. 2) (4560. 2) (4697. 0)

Annual residual cash flows 91795. 8 104647. 3 119297. 7 135999. 4 140079.

4

Terminal value 4013736. 4

Residual cash flows \$91, 795. 8 \$104647. 3 \$119297. 7 \$135999. 4

\$140079. 4

NPV capital provider \$83, 451

Value of debt (\$1, 052)

Residual value \$82, 399

Terminal value is = $140079.4 / (0.0649 - 0.03) = 4013736.4$ Sears free cash

flow and Valuation (In the millions of dollars) Assumptions Sales growth 15%

Debt \$30, 637 Debt/total capital 82% Terminal sales growth 5% Required

ROE 20. 4% Sales 2002 \$41, 366 Operating expenses 63% Marginal cost of

debt 6. 75% WACC 6. 94% Exhibit - Sears Income Statement changes 2003

2004 2005 2006 2007

Sales \$47570. 9 \$54706. 54 \$62912. 5 \$72349. 4 \$75966. 9

Operating expenses (29969. 7) (34465. 1) (39634. 9) (45580. 1) (47859. 1)

Gross profit 17601. 2 20241. 4 23277. 6 26769. 3 28107. 8

Depreciation (875) (1006. 3) (1157. 2) (1330. 8) (1397. 3)

Profit before taxes 16726. 2 19235. 1 22120. 4 25438. 5 26710. 5

Taxes (858) (986. 7) (1134. 7) (1304. 9) (1370. 1)

Profit after taxes \$15868. 2 \$18248. 4 \$20985. 7 \$24133. 6 \$25340. 4

No cash changes depreciation 875 1006. 3 1157. 2 1330. 8 1397. 3

Balance sheet change (875) (1006. 3) (1157. 2) (1330. 8) (1397. 3)

Annual residual cash flows 15868. 2 18248. 4 20985. 7 24133. 6 \$25340. 4

Terminal value 1306206. 2

Residual cash flows \$15868. 2 \$18248. 4 \$20985. 7 \$1330339. 8

NPV to all capital provider \$37, 390

Value of debt (\$30, 637)

Residual value \$6753

*Terminal value = $25340.4 / (0.0694 - 0.05) = 1306206.2$ I conclude some own viewpoints on WACC that are:

- The weights are the percentages of the firm that will be financed by each component.
- Project risk level = company risk level
- If possible, always use the target weights for the percentages of the firm that will be financed with the various types of capital.
- Three factors influence a company's WACC: 1. Market conditions, especially interest rates

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and tax rates. 2. The firm's capital structure and dividend policy. 3. The firm's investment policy. Firms with riskier projects generally have a higher WACC. Working Capital Management Accounts Receivable Both Wal-Mart and Sears are running the retail business. They sell almost everything that we need in our life. Also, there are not only one or two chain stores they are running with; they have more than 1000 chain stores to run with their business.

Regarding of their huge chain stores, how to management the working capital management affect the entire organization success or not. Wal-Mart is the biggest retail business in the world. They also expense their market into world and become an international business. They sell products by their retail stores and internet stores, and these stores are running their business very well. While internet just being popular, Wal-Mart knows that internet will become a very import field to selling their products, especially they are selling almost everything what we need. Also, they think they have the advantage by the tradition selling mode and have a lot of experience of selling their products on real stores. They decide to build their own web-site and sell their products thought internet. Although they did not earn profits in the beginning, but the company are earning lots of profits from the internet stores for sure.

Since the company is getting bigger and bigger, the company spent their money become more than before. This makes account receivable become very important to the company. If the customers do not pay their credit on time, the company will have a huge loss of their profit. But if company does

not take the risk, the company might lose many customers. This makes Wal-Mart provide their own credit card and shopping card. They promote their credit card and promote by “no interest for three months”. While customers purchase more than 250\$ from their stores, they will not charge the interest rate during the 3 months. I think this strategy will attract both new and old customers. In North America, most customers won't go shopping everyday, they always buy their needs once a week or month, so every time while customers go shopping, they will buy large amount of needs which means most of the purchase will more than 250\$.

This makes old customers who don't have the wal-mart credit card would think to apply one, and the promotion will attract new customers who usually shop at other stores but do not have this kind of benefit of credit card. The shopping card is more directly than credit card, customers just need to buy any amount (more than 10\$) of the store credit and they can shop on internet store and retail stores. If customers do not want to spend money on the cost of the credit cards, they can shop with the shopping card without paying any interests. Unlike credit card, the company can earn their accounts receivable before customers purchase any item. Sears is also providing the sears credit cards to their customers. The different between sears and Wal-Mart is sears provide six kinds of credit cards which are the sears card, sears gold master card, sears premier card, sears premier gold master card, sears home improvement account, and sears commercial one business account. Sears provide all kind of level of benefit to attract their customers to apply their credit card.

While customers purchase more products from sears by credit card, they will earn more profits of it. I think this strategy can attract customers to purchase more items from sears because most of the customers will like to get best benefit of the credit card. It can also maintain the old customers because they will keep purchase to get a high level of credit card. Both of Wal-Mart and sears are using the credit to attract the customers because they understand credit card business is huge and can earn lots of profit for them but there is still some risk in this field which is they might not able to get the money back from the customers. But both companies decide to take this risk and server their customers very well, and I believe that both companies are getting better and better. Inventories Keeping the inventories is the retail store's most expense. If company is maintaining too much inventory is expensive, but too less inventories might cause out of stock and may result in lost sales.

So how to keep the inventories become most import thing to the retail store. Both sears and Wal-Mart have the information systems that have entire customers' information and they know what customers need. They use these data to adjust the level of the inventories. Both of their warehouses are connecting with the suppliers. While the inventories less than replenish point, the computer will automat connect the supplier to ship the item which they need and maintain their inventories. This system can reduce of the cost of the inventory and will not able to run out of the stocks. V. Dividend policy and tax treatment impacts

	2002	2001	2000	1999	1998
Wal-Mar	18.80%	17.10%	16.70%	16.10%	17.90%

Sears 21. 40% 41% 23. 70% 24. 10% 37. 70%

The dividend policy means how to deal with the dividend the company. For example, pay dividend or not pay dividend and how much dividend is paid. When we decided the dividend police we should separate four steps. First, we should determine the optimal amount of capital investment budget. Second we should determine the amount of equity needed to finance that budget. Third, we should retained earning to supply this equity to the extent possible then pay dividend only if more earnings are available than are needed to support the optimal capital cost. So when the company has had good performance during the past year, it has pretty big net income. Besides keeping certain retained earning for the future investment, it will pay dividend to its shareholders. A company might get a little net income, but it has no big plan in the next year. In this situation, keeping high retained earning would reduce its profitability.

So the company will pay high percentage dividends of its net income to its investors. I think the Wal-Mart is belong to first kind of company, it earned many money but it need money to invest to new market, so it paid a low percentage of net income. But Sears didn't have new project to invest so it paid high percentage net income to shareholders. As we all know, dividend is one part of net income. When the investor get dividend they should pay the income tax. We also know before company get net income, they had paid tax. So when the investors get the dividend they should pay double tax. Few investors like to do that. But when the government charge low tax rate the

investor will like to get more dividend. So tax rate will affect the dividend police.

How to reduce the tax payment and increase the dividend is the company wants to do. We also know the interest is subtracted before the tax imposed. If we can pay more interest then the net income will reduce and the tax also will reduce. It means we can borrow money from bank and use this money to pay dividend. We only need pay one tax plus interest of this money. The interest rate is lower than tax. So the investor can get more. We can see the flowing chart. It tells us Wal-Mart and Sears all borrowed money, maybe it is need for investment also it can reduce the tax payment

Total liability to assets	2002	2001	2000	1999	1998
Wal-Mart	55.10%	57.10%	60.00%	52.70%	53.20%
Sears	60.10%	58%	48.40%	51.50%	52.20%

Wal-Mart 55.10% 57.10% 60.00% 52.70% 53.20%

Sears 60.10% 58% 48.40% 51.50% 52.20%

But a company can't borrow too many money, heavy liability will increase the risk of investor, and influence their confidence. Conclusion Through our simple financial analysis, we can't say which company is better. Wal-Mart and Sears all can get good profit every year. But Wal-Mart's stock price is too high now, their stock price has almost got the lever of some high-technology company, we think it should be too high. Sears' stock price is only half of Wal-Mart and it paid higher dividends than Wal-Mart. So we think Sears should be a better selection from investment position.