Credit appraisal

IES FSV UK

Course: Banking

December 2012

Wal-Mart Stores, Inc

XXX as representative of a bank mail

Credit application by xxx, xxx

1. Client details

Name:	Wal-Mart Stores, Inc
Legal Status:	Public corporation
Domicile:	not specified
Telephone:	not specified
Industry:	Retailing

2. Credit details

Business plan:	Acquisition of ware house facility (location not specified)
Type of financing:	Loan
Total amount:	$ 1,000,000, 000
Annual interest rate:	4% p.a.
Type of depreciation:	Annual (4% depreciation rate)
Repayment frequency:	semi annually
Maturity:	10 years (Jan 1, 2013– Dec 31, 2023)
Schedule:	The first instalment will be paid on (the exact date was not specified) January 2014 and the last one on 31th December 2023
Collateral:	None

Non-financial analysis

SWOT analysis

Wal-Mart is the biggest retailer in the world. It has a long history (it was established in 1969) and very strong brand. As mentioned in the credit application the main strengths of Wal-Mart are the low prices and very big share of market. Moreover, their products are sufficiently diversified to attract a broad range of customers. The only problem of this "low prices strategy" is that to lower prices people attribute lower quality. There is probably no real identification of the customer with the brand and therefore the threat of competitors is very high. In case there will be a competitor that would be able to offer the same (or similar) products for lower prices the customers of Wal-Mart will switch to him. Also if the customer reaches a higher income class, he/she will probably search for another retailer that provides something "more than standard".

The mentioned weaknesses seem not to be related to Wal-Mart. Rather than listing the weaknesses of Wal-Mart, the applicants speak about the negative impacts that Wal-Mart has on the competitors and on the US society. Beside the above mentioned weakness (the "assumed low quality" problem), we would like to add another possible weakness of the company. The company is very big and the structure is complicated which can lead to control problems.

The listed opportunities are, from our point of view, rather strengths of the company. We would like to add the opportunity of entering other markets (either other segments, or expanding into other countries). The question is whether this would be feasible, because there were already some attempts to expand (for example in Germany) which were not successful (maybe it was due to the fact that some cultures are not so opened to such standardised and cheap products).

Together, we see no big shortcomings in the non-financial analysis. The company seems to be strong and successful and it has a stable position in the market. There is no evidence that this should change in the future.

Credit application structure

The credit application is not well-structured and does not satisfy the requirements of the bank. The first page with basic information about the company and about the loan is missing. We miss also information such as domicile of the company, telephone or e-mail on the contact person. Moreover, there are some parts which need not to be included in the credit application (such as too detailed description of the company and description of the ratios) and the application is therefore more complicated and confusing. On the other hand we appreciate the map of Geographic locations of Wal-Mart Company that was very helpful (we can better imagine the exact locations of Wal-Mart stores).

Financial analysis

The financial analysis is based on financial statements of past three years (31.1.2010, 31.1.2011 and 31.1.2012).

Income statement

The income statement shows a good position of the firm. The items are nearly stable (there are no big raises or drops in individual items). Sales are growing a little less than cost of goods, but the net profit excluding extra items is rising over time. We have recognized some mistakes in the excel sheets. In the item Earnings from discounted operations the numbers were in 2011: 1034 Millions of US Dollars and in 2012: -67 Millions of US Dollars, which is a drop of 1101 Millions of US Dollars. But in the sheet that reports the growth rates, there is reported a positive growth in Earnings from discounted operations from 2011 to 2012 of 106%.

Balance sheet

The balance sheet seems to be nearly stable. The assets increased by 6% and 7% respectively in 2011 and 2012. There was a quite high increase in accounts receivables which can signal either increased sales (this was probably the case) or lower ability to collect the receivables - to decide we will need account receivables ratio.

Cash flow statement

In both years (2011 and 2012) there was a decrease in cash. But the decrease was not so high to consider it as dangerous.

Ratio analysis

Given the ratios provided by the applicant, we can conclude that Wal-Mart Stores, Inc performed well in last years. The current ratio was slightly under 90% which indicated high liquidity. The profitability ratios seem to be stable over time and we can conclude that the profitability of the firm is quite high. (But we will need a comparison to similar company to be able to do a precise conclusion whether Wal-Mart is performing better or worse than other retailers.) Regarding the activity both, inventory turnover and total assets turnover, decreased a little over time, but the change was only marginal. In total, the activity ratios remain high. Debt-to-equity ratio increased from 45,5% to 58% which means that increasing part of assets is financed by long term loans.

To improve this section, it would be helpful to have some description of the financial statements. Moreover, we would suggest to use more simple financial statements (to keep it clear). For example, here is no need to include accounts receivables and total receivables in the balance sheet as two separate items as they are the same. The same is in the Cash flow statement, where the depreciation and amortization is written twice without any reason.
We would appreciate comparison to some company that operates in the same sector. Moreover, it would be helpful to have appraisal from some rating agency or some other independent evaluation of the financial health of the company.
Together, the company seems to be in a good financial position and we assume that there should be no problem with the financing of the loan.

Feasibility of the business plan

Whereas in the non-financial and financial analysis there are no big shortcomings, there are significant lags in the business plan and in the project planning.
There is no sufficient description of business plan. The applicants describe only the aims regarding the profit (it should increase by 3% within 5 years). Beside this, they plan to build 15 to 20 Wal-Mart discount stores focusing on Arkansas, North Carolina and Chicago in 2013.

We strongly advise to extent this chapter. The main problem is that there is no description of the forecast. We do not know how the forecast was done, based on which facts, what were the methods used. The whole forecast is very simplified, we do not see any reason why the items such as Earnings from discounted operations, Long-Term Investments, Accrued Expenses and other should remain the same in the next five years. Moreover, we do not understand why in the forecasted balance sheet there are two separate items – accounts receivables and total receivables – which are nor equal, despite that there are no other types of receivables listed.

On the other hand, we cannot reject the forecast in general, because as long as we are not sure about the methods used to do the forecast it is possible that they are done correctly.

Feasibility of the project

The project that should be financed through the loan is an acquisition of ware house to expand the new discount store. We appreciate the detailed description of the different phases of the project implementation. But there are huge lags in the costs estimation and financial statements. First, we assume that $1,000,000,000 for a ware house is highly overestimated. Nearly all data in the financial statements are hard-coded and it is very difficult to find the origin of them. There is no reason, why the revenues (cost of goods sold) of the project should be 2% (3%) of total revenues (total cost of goods sold) from the previous year (an explanation is needed). The next big problem in the income statement is that the applicants write that the net income of the project is zero. We have computed the income alone, using the numbers provided by the applicants, and we have found out that there will be a loss (see table below – there is no specification of the currency in the income statement of the project, we assume the applicant did it in Millions of US Dollars).

Year	Net Income (in Millions of US Dollars)
2013	-1114,809581
2014	-1267,119169
2015	-1441,452001
2016	-1630,162723
2017	-1835,616228

We assume the losses will be even higher, because there are no operating expenses included in the income statement of the project, which we assume to be highly unrealistic.

In the balance sheet, there is no depreciation included, despite the fact that the applicants assume a depreciation of 4% over next 30 years. The depreciation is included in the Cash flow statement of the project, but we do not understand, how it is computed. The depreciation increases over time and it seem not to be 4% of the investment. All together the Cash flow statement of the project seems not to be correct, because the indicated interest expense is not consistent with the one indicated in the loan sheet. There is also indicated profit and costs which we do not know from where they come (as all the data are hard-coded there is no possibility to check the correctness).

Further we miss some specification about the project such as location of the ware house.

- **SWOT Analysis**

Strengths	Weaknesses
+ Experience in building ware houses + Strong brand + High liquidity + Know-how	- The project is not profitable (losses in every year) - High costs of the construction - Location of the warehouse is not specified - Not well-planned project
Opportunities	**Threats**
+ Gaining higher market share + Transfer of know-how + Improved logistic	- High competition - Increased indebtedness - Insolvency

Pro / Cons for the credit:

Despite the current good financial position of the company, we must reject the credit application. The main reasons are the above mentioned shortcomings in the application. Moreover, we view the suggested interest rate as too low. A realistic interest rate for our bank would be about 5%. The interest rate will be dependent on the collateral. In the current application, there is no collateral, which is not acceptable for our bank, because despite the fact that Wal-Mart is a big company with stable incomes, the risk will be too high. Moreover, we would suggest instalments that would be more frequent (monthly, or at least quarterly).

Conclusion and Strategy: We **REJECT** the credit application.

DECISION OF CREDIT COMMITTEE

Date____4.12.2012_______ …~~../approved~~ ……../ not approved . …..~~/ approved with~~ conditions

~~Remarks:~~ ____

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Signatures: ____

Attachments:

Recommendations: What is needed to improve:

1) Obligatory

   -definition of credit collateral

   -change the structure (it must satisfy the required form)

   -change of the interest rate

   -correcting the investment forecast (the costs are overestimated)

   -correcting the mistakes in financial statements (the mistakes are indicated above – feasibility of the project is needed)

2) Welcomed by creditor

   -better explanation of the forecast

   -comparison with similar companies

   -independent appraisal by rating agency