# Financial Accounting Exam 1.1

Professors G. Peter and Carolyn R. Wilson

- The exam packet is comprised of :
  1. This 26-page document, which contains the questions you are to answer, and excerpts from Dillards footnotes. Write all of your answers in this document, put your name on each page, and submit the document for grading.
  2. The exam supplement, which contains a chart of accounts for **all** exam entries, BSE matrix for a fictitious company, and financial statements from Dillards fiscal 2012 annual report.
     - ***Dillards fiscal 2012 year ended on February 2, 2013.***
     - Dillards ranks among the nation's largest fashion apparel, cosmetics and home furnishing retailers. (2012 annual report)

  3. Scrap paper. Additional scrap paper is available at the front of the room.
- There are 20 possible points on the exam that can be applied to your course grade. Except for the essay portion of the exam, partial credit will not be awarded, so check your answers carefully.
- The exam is closed book and closed notes.
- You cannot use a laptop, tablet, cell phone, or other communication or mobile device.
- You may bring a calculator for your individual use (not to be shared with others), but your calculator must not contain course related information. We reserve the right to inspect your calculator and, in our sole judgment, deem it inappropriate for use during the exam. We will have basic calculators available for you to borrow.
- You may bring a hardcopy dictionary and/or a hardcopy grammar/style book for your individual use (not to be shared with others), but it must not contain course related information, either as handwritten notes or attached/inserted notes. No electronic dictionaries or grammar/style books allowed. We reserve the right to inspect your dictionary and grammar/style book before the exam and randomly during the exam. As a result, we may, in our sole judgment, deem it inappropriate for use during the exam.
- You are required to TURN IN ALL MATERIALS when you have finished the exam, including the exam document, the exam supplement, and all scrap paper (provided). Moreover, once the exam starts, you may not take any materials from the room, including the above and your dictionary or grammar/style book, if you brought them.
- If, in our sole judgment, we cannot read your responses to question 7, you will not receive full credit. If it's determined we cannot read your responses, you will be contacted and given an opportunity to type up your responses EXACTLY as written in your exam by a given time. No content changes are allowed. In this case, you will be penalized 1 point for not writing clearly.
- Regardless of one's intent, staring at classmates' exams is inappropriate. If you wish to take a break from staring at your exam, stare directly ahead or to either side without looking down.

## Question 1

For parts (a) - (d) you are to record journal entries for CC's Music Store. (1) Write your journal entry in the space provided below each question. (2) Use the *most* appropriate accounts from the chart of accounts in the exam supplement (it contains some accounts that are not appropriate).
(1/2 point each, for a total of 2 points)

### Part 1(a)

**Record a journal entry for the following:**

On December 1, 2012, CC's Music Store paid $350 for insurance that will provide future benefits. The cost will be expensed when the benefits are realized in the future.

*Note: Four rows have been provided, but you may not need them all.*

| | Debit | Credit |
|---|---|---|
| | | |
| | | |
| | | |
| | | |

### Part 1(b)

**Record a journal entry for the following:**

During December 2012, CC's Music Store sold products to customers for $1,700 of which $1,100 was collected at the time of the sale and the remainder was fully expected to be collected within the next 30 days. The company policy is to recognize revenue at the time products are sold, providing collection is reasonably assured.

*Note: Four rows have been provided, but you may not need them all.*

| | Debit | Credit |
|---|---|---|
| | | |
| | | |
| | | |
| | | |

## Part 1(c)

**Record a journal entry for the following:**

During December 2012, the products sold cost $500.

*Note: Four rows have been provided, but you may not need them all.*

| | Debit | Credit |
|---|---|---|
| | | |
| | | |
| | | |
| | | |

## Part 1(d)

**Record a journal entry for the following:**

During December 2012, CC's Music Store recognized $325 of selling, general, and administrative expense. $200 was recognized when the company received invoices from its suppliers. The remaining expense was recognized when the company paid its suppliers.

*Note: Four rows have been provided, but you may not need them all.*

| | Debit | Credit |
|---|---|---|
| | | |
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| | | |

## Question 2

For parts (a) - (b) you are to create a balance sheet and comprehensive income statement for Charlene's Quilts Company after you complete the closing entries in the **BSE matrix in the separate exam supplement**. You will not receive credit for completing the BSE matrix.
(1/2 point for each statement, for a total of 1 point)

### Part 2(a)

Complete the following balance sheet Charlene's Quilts:

**Charlene's Quilts**
**Balance Sheets**

| | | |
|---|---|---|
| **Assets** | **31-Jan-12** | **01-Jan-12** |
| **Current** | | |
| Cash | ________ | $0 |
| Accounts receivable | ________ | 0 |
| Short-term investments | ________ | 0 |
| Inventories | ________ | 0 |
| **Total current assets** | ________ | **0** |
| **Non-current** | ________ | 0 |
| **Total assets** | ________ | **$0** |
| | | |
| **Liabilities and Stockholders' Equity** | | |
| **Liabilities** | | |
| **Current** | | |
| Accounts payable | ________ | $0 |
| Accrued compensation and benefits | ________ | 0 |
| Income taxes payable | ________ | 0 |
| **Total current liabilities** | | **0** |
| **Non-current** | ________ | 0 |
| **Total liabilities** | ________ | 0 |
| **Stockholders' equity** | | |
| Common stock | ________ | 0 |
| Retained earnings | ________ | 0 |
| **Total stockholders' equity** | ________ | 0 |
| **Total liabilities and stockholders' equity** | ________ | **$0** |

## Part 2(b)

Complete the following comprehensive income statement for Charlene's Quilts:

**Charlene's Quilts**
**Comprehensive Income Statement**

| | |
|---|---|
| January 1 - January 31, 2012 | |
| **Operating profit** | |
| Revenues | |
| Cost of sales | |
| Marketing general and administrative | |
| Profit from operations | |
| **Non-operating profit** | |
| Interest income | |
| **Profit before taxes** | |
| Tax expense | |
| **Net profit** | |
| **Other comprehensive income** | 0 |
| **Comprehensive income** | |

## Question 3

**RELEVANT INFORMATION for QUESTION 3**
The format for parts (i)-(ii) of question 3 is the same as the format for clicker questions discussed during class. **You MUST CIRCLE the letter associated with the best response to receive credit.** (1/2 point each for a total of 1 point)

### Question 3(i)

**CIRCLE the letter associated with the best response.**
Based on the available information in the exam and exam supplement, it is reasonable to conclude:

(a) As of February 2, 2013, Dillards expected to collect $31,519 thousand from its customers (or possibly others) during the next year.

(b) Dillards didn't buy any inventories during the year ended February 2, 2013 because the merchandise inventories balance decreased from $1,304,124 thousand to $1,294,581 thousand.

(c) Dillards spent $1,671,526 thousand of cash on selling, general and administrative expenses during the year ended February 2, 2013.

(d) (a) and (b)

(e) (a) and (c)

### Question 3(ii)

**CIRCLE the letter associated with the best response.**
Based on the assumptions and available information in the exam and supplement, it is reasonable to conclude:

(a) Dillards received more contributions from owners than it distributed to owners in dividends and stock repurchases during the year ended February 2, 2013.

(b) Dillards other comprehensive income was positive during the year ended February 2, 2013 and negative during the year ended January 28, 2012 (representing a loss).

(c) Dillards other comprehensive income during the year ended February 2, 2013 equals its comprehensive income less net income recognized during the year ended February 2, 2013.

(d) (a) and (c)

(e) (b) and (c)

## Question 4

**RELEVANT INFORMATION for QUESTION 4**
Base your responses to part (a) and (b) on Dillards financial statements in the exam supplement.

### Part 4(a)

**Record a single journal entry that summarizes the entries Dillards recorded during the year ended February 2, 2013 to declare dividends and the entries Dillards recorded to pay dividends (as indicated below) to all shareholders who have claims on the net assets controlled by Dillards.**

**Note: Dillards' cash flow statement reports that it paid $252,341 in dividends during the year ended February 2, 2013.** [**Hint**: This may or may not be the same as dividends declared during the year. If you prefer, you can record two entries in the space provided below: one for the dividends declared and another for the dividends paid.]
(1 point)

(1) Write your journal entry in the space provided below. (2) Use the *most* appropriate accounts from the chart of accounts in the exam supplement (it contains some accounts that are not appropriate).

*Note: Four rows have been provided, but you may not need them all.*

| | Debit | Credit |
|---|---|---|
| | | |
| | | |
| | | |
| | | |

### Part 4(b)

**Determine the direct effect(s) on the following Dillards metrics for fiscal 2012, everything else equal, for the entry in Part 4(a) [that summarizes the entries Dillards recorded to declare dividends and the entries Dillards recorded to pay dividends during the year ended February 2, 2013]. Ignore taxes.**
(1/4 point per ratio, for a total of 1 point.)

**If an incorrect entry in part 4(a) leads to errors here, you won't receive credit here.** Thus, check your part 4(a) entry carefully.

**Guidance:**
Include the direct affects, including the effect(s) of closing entries for events affecting income.

You must put an "X" in the appropriate box to receive credit. You will not receive credit if you put an X in more than one box per metric.

| | Increases | Decreases | No Effect |
|---|---|---|---|
| **Working capital** (current assets - current liabilities) | ☐ | ☐ | ☐ |
| **Asset turnover** (revenues / average assets) | ☐ | ☐ | ☐ |
| **Profit margin** (pretax profit / revenues) | ☐ | ☐ | ☐ |
| **Return on equity (ROE)** (net profit / average owners' equity) | ☐ | ☐ | ☐ |

## Question 5

**RELEVANT INFORMATION for QUESTION 5**
Base your responses on Dillards financial statements in the exam supplement.

**Record a single journal entry that summarizes the entries Dillards recorded during the year ended February 2, 2013 for its purchase of treasury stock with cash.**

**Note: Dillards' cash flow statement reports that it paid cash for all treasury stock purchased during the year ended February 2, 2013.** The "treasury stock" account is a contra owners' equity account and reduces the value of total owners' equity.
(1 point)

(1) Write your journal entry in the space provided below. (2) Use the *most* appropriate accounts from the chart of accounts in the exam supplement (it contains some accounts that are not appropriate).

*Note: Four rows have been provided, but you may not need them all.*

| | Debit | Credit |
|---|---|---|
| | | |
| | | |
| | | |
| | | |

## Question 6

**RELEVANT INFORMATION for QUESTION 6**
Base your responses to part (a) and (b) on Dillards financial statements in the exam supplement.

### Part 6(a)

**Note**: The Advertising section of the Dillards' Summary of Significant Accounting Policies footnote reports (page F-13, 2012 10-K):

> Advertising —Advertising and promotional costs, which include newspaper, magazine, Internet, broadcast and other media advertising, are expensed as incurred and were approximately $77 million, $99 million and $107 million, ... for fiscal years 2012, 2011 and 2010, respectively. The Company records net advertising expenses in selling, general and administrative expenses.

**For the purpose of this exam, assume:** the $77 million of advertising expense has three components: (1) $25 of the expense was paid previously; (2) $14 of the expense is paid when the expense is recognized; and (3) the remaining $38 of expense will be paid at a later date. Further assume Dillards has not yet been invoiced for this $38 and the company's policy is <u>not</u> to record obligations to accounts payable until it is invoiced.

**Record a journal entry that recognizes Dillards' advertising expense during the year ended February 2, 2013 (fiscal 2012), given the above assumptions.**

(1) Write your journal entry in the space provided below. (2) Use the *most* appropriate accounts from the chart of accounts in the exam supplement (it contains some accounts that are not appropriate).

*Note: Four rows have been provided, but you may not need them all.*

| | Debit | Credit |
|---|---|---|
| ______________________ | ________ | ________ |
| ______________________ | ________ | ________ |
| ______________________ | ________ | ________ |
| ______________________ | ________ | ________ |

## Part 6(b)

**Identify the Dillards financial statement line items that would have been directly affected (and the direction of the effects) if Dillards had recorded the journal entry in Part 6(a) for the advertising expense during the year ended February 2, 2013, given the assumptions in 6(a).** (1/2 point per statement, for a total of 2 points.)

**If an incorrect entry in part 6(a) leads to errors here, you won't receive credit here.** Thus, check your part 6(a) entry carefully.

**Guidance:**

(1) Determine the appropriate line item(s) [not accounts] affected using Dillards' statements. For example, write "cash and equivalents" rather than "cash" because this is on Dillards' balance sheet.

(2) Include line item(s) directly affected, including the effect(s) of closing entries for events affecting income. Ignore taxes.

(3) Don't include totals or sub-totals indirectly affected by the entry. For example, don't report "net income" on the income statement. However, net income is NOT a total on the statement of stockholders' equity.

(4) Four lines were included below for each statement, but you may need none or more than one line. **For full credit, write "NONE" if no line item is effected on the statement.**

(5) Indicate if the effect(s) of the entry associated with the above event increased or decreased the line item. Put an X in the appropriate column if the above event increases or decreases that line item. For full credit, be sure to mark only one box in each statement's row. **NOTE: If a reported negative number changes from -2 to -3, it decreases; if it changes from - 2 to - 1, it increases.**

(6) You won't receive credit for a statement if you list line items not affected by the entry: don't guess!

**Balance Sheet**

| Line Items | Increases | Decreases |
|---|---|---|
| ______________________ | ☐ | ☐ |
| ______________________ | ☐ | ☐ |
| ______________________ | ☐ | ☐ |
| ______________________ | ☐ | ☐ |

**Statement of Stockholders' Equity**

| Line Items | Increases | Decreases |
|---|---|---|
| ______________________ | ☐ | ☐ |
| ______________________ | ☐ | ☐ |
| ______________________ | ☐ | ☐ |
| ______________________ | ☐ | ☐ |

**Income Statement**

| Line Items | Increases | Decreases |
|---|---|---|
| ______________________ | ☐ | ☐ |
| ______________________ | ☐ | ☐ |
| ______________________ | ☐ | ☐ |
| ______________________ | ☐ | ☐ |

## Question 7

**RELEVANT INFORMATION for QUESTION 7**
The format for question 7 requiring analyses is similar to the group assignments.

While there aren't correct responses to the question, some are definitely better than others. Generally, responses are better to the extent they are well organized, concise, use proper grammar, identify the most important arguments, counterarguments, and rebuttals, include appropriate qualifiers, and provide insights regarding the way you assessed the relative merits of the arguments, counterarguments and rebuttals.

Additionally, responses must cite sources and use quotation marks when copying word for word.

**YOU MUST WRITE CLEARLY WITHIN THE GIVEN LINES TO RECEIVE CREDIT. YOU DO NOT NEED TO USE ALL THE SPACE TO RECEIVE FULL CREDIT. THE MARGINS ARE RESERVED FOR GRADING COMMENTS.**
**If, in our sole judgment, we can not read your response you will not receive full credit.**
(total of 10 points)

### Required

In this question, you will explore Target's and Walmart's future ROEs and risks.

**Based solely on concepts covered thus far in the course and the provided background information and tabular data, which company, Target or Walmart, appears to have the better future prospects at the most recent balance sheet dates, taking into consideration expected future ROEs and risks?**

**Notes:**

- The calendar dates for the companies' fiscal year ends differ only by a few days; but the companies refer to their fiscal years differently. For example, Target's **fiscal 2012** ends on February 2, 2013 and Walmart's **fiscal 2013** ends a couple of days earlier on January 31, 2013. To avoid confusion regarding fiscal years, we will refer to these dates as the most recent balance sheet dates.
- **If you conclude one company doesn't dominate the other on both factors (ROEs and risk):** In your opening remarks, (1) identify the company that has the best prospects for each of the factors; and (2) incorporate the companies' relative strengths into your arguments, counterarguments, and the confidence you attribute to your claim.

Respond to this question by completing the templates in Parts I-III.

### Background Information

#### Excerpts from February 27, 2013 conference call Target Executives had with analysts

Shortly after the end of fiscal 2012, Target held an on-line conference call with financial analysts and others to discuss Target's fiscal 2012: performance for the fourth quarter; performance for the entire year; financial position at the end of the year; and future plans and strategies, including those not yet reflected in the company's financial statements. The following quotes are from a transcript of this conference call prepared by Thomson Reuters Streetevents. They include statements by Target executives followed by questions from analysts and related responses.

**Gregg Steinhafel - Target Corp - President & CEO**

"Our US operations generated fourth quarter adjusted earnings per share of $1.65, 10.1% above last year and in line with our prior guidance, even though sales fell short of our expectations. Our fourth quarter

GAAP earnings per share were $1.47, reflecting **Canadian segment dilution** that was slightly favorable to our expectations. As we previously reported, fourth quarter **comparable store sales** in our US retail segment grew 0.4%, compared with an expected increase of 2% to 3%."

> **Note**: "Canadian segment dilution" means the Canadian business segment's earnings per share were losses and thus lowered Target's overall earnings per share.

> **Note**: "comparable store sales in our US retail segment grew by .4%" means sales in established stores (that have been operating for a couple of years) have increased by .4%. This information helps analysts distinguish sales growth due to established stores from that due to new stores.

"In our Canadian segment, preparations for our market launch are reaching their peak. We expect to open our first 24 Canadian stores by early April; and after more than two years of effort, our Target Canada team is eager to welcome their first guests [customers] and begin generating sales. … For the year, we expect to open 124 Canadian Target stores in five waves before the Christmas holiday season."

…

"As we enter 2013, we will plan appropriately, as the US economy is growing at a painfully slow rate and unemployment remains persistently high. While there are some encouraging signs in the housing market, volatility in consumer confidence, the payroll tax increase, and rise in the price of gas all present incremental headwinds. Given these new challenges facing an already sluggish economy, we have a tempered view of the near-term sales environment. However, as we have seen in the past, our guests are quite resilient."

…

"We believe that we are well positioned to succeed, even in this uncertain environment. We'll focus on providing unbeatable value and back up that commitment with our newly enhanced price match policy, which now covers offers from key online competitors year round. We're also committed to taking smart risks on bold innovative ideas and learning quickly from the results. We'll raise the bar in differentiation, providing our guests unique products and experiences at affordable prices. And as Kathee will outline in more detail, we will continue to partner with designers on unique collections that embody the Expect More side of our brand promise and remind guests why Target is special."

**Kathee Tesija - Target Corp - EVP, Merchandising**

"Though we fell short of our overall sales goal for the fourth quarter, we were pleased that we grew comparable store sales in four of our five merchandising categories and that we sustained our profitability in the face of choppy consumer spending and an intensely competitive environment. Consistent with the rest of the year, fourth quarter comparable store sales were strongest in our less discretionary frequency businesses, which saw growth in the low to mid-single digits. In both of our discretionary Home and Apparel categories, fourth quarter comparable store sales increased in line with the Company average and saw rapid growth in our digital channels. Fourth quarter comparable store sales in hard lines declined in the mid-single-digit range and were softest in Electronics. Many more electronics categories are in mature stages of the product cycle; and during the holiday season, electronics constitutes the primary battleground where competitors engage in their most irrational promotions. In Toys, overall fourth quarter comparable store sales were down slightly overall, but increased about 30% through our digital channels."

…

"As Gregg mentioned, fourth quarter sales in our digital channels was quite strong, having accelerated throughout the year, as we improved site stability and speed while enhancing search and navigation. These investments are clearly driving higher overall guest satisfaction; and with our continued focus on expanded content and site functionality, we expect continued improvement in 2013. We're also seeing amazing growth in traffic and sales through our mobile platforms. Mobile purchases now constitute more than 7% of our digital sales and mobile traffic is now more than 25% of our overall digital traffic."

…

"After improving gradually in 2012, consumer sentiment fell sharply in the fourth quarter, reflecting turmoil surrounding the fiscal cliff and overall political uncertainty. In addition, more than 50% of US consumers believe that the economy will either remain the same or get worse in 2013, and 85% indicate they expect the economy to impact their lifestyle for the next several years. Beyond these potential headwinds to consumer spending, the average US household will see a $1,000 reduction in their after-tax income as a result of the recent increase in payroll tax rates. However, even in this challenging environment, we expect to win by strengthening guest loyalty and driving increased sales through merchandising that supports both sides of our Expect More, Pay Less brand promise. We'll continue to match prices on identical items offered by both store-based and online competitors. And we'll offer guests affordable products and experiences that allow them to treat themselves and their families, while staying within their budgets.

For example, in Apparel we're very pleased with the response to our current designer partnership, Prabal Gurung for Target. Prabal is one of the most celebrated designers in the fashion industry, and this collection embodies his signature style and design aesthetic, all at affordable prices. The Prabal Gurung for Target collection features ready-to-wear, handbags, shoes and jewelry that provide key differentiation for Target this spring."

**John Mulligan - Target Corp - EVP, CFO**

"In our US Credit Card segment, performance in the fourth quarter was outstanding once again. … The superior performance and profitability of this asset enabled us to reach a sale and servicing agreement with TD Bank, a premier financial institution that shares our goals for portfolio growth and profitability."

**Note**: Target sold its credit card business to TD Bank shortly after the close of fiscal 2012. However, because the sale was planned prior to the end of fiscal 2012, Target was required to write the carrying value of the business to its fair value in fiscal 2012, which resulted in a gain of $161 million in fiscal 2012 income.

**Questions and Answers**

*Question from Morgan Stanley - Analyst*

Can you give us a little more color on the Canada dilution of $0.45? I think that's bigger than a lot of people were expecting, and it sounds like a lot of it's related to the capital spending decisions. If you could walk us through that a little bit?

*Response from Target Corp - EVP, CFO*

"… The dilution is a bit higher even than we expected, perhaps a year ago; and all of that is attributable to independent capital investment decisions we've made, whether that's investing in three distribution centers to build them and own them ourselves, or the 40 store expansions that I mentioned that we worked through over the past year. So most of the increase, from our vantage point, is attributable to incremental depreciation and amortization. And of course, those capital investments were separate economic decisions and we expect to see economic benefit to that P&L [profit and loss or income] through time. But the sequencing is that the depreciation and amortization shows up first."

**Excerpts from February 21, 2013 conference call Walmart Executives had with analysts**

Shortly after the end of fiscal 2013, Walmart held an on-line conference with financial analysts similar to the one Target held (discussed earlier). The following quotes are from a transcript of this conference call prepared by Thomson Reuters Streetevents. The Walmart transcript didn't include questions from analysts and related responses.

**Mike Duke - Wal-Mart Stores, Inc. - President & CEO**

"Our financial priorities remain growth, leverage, and returns, and those themes are reflected in what you hear from us today. Let me share with you the key areas that our management team is focused on that are critical to Walmart's long-term success. They are -- delivering a strong Walmart U.S. business, improving returns for International, driving greater efficiency through disciplined capital allocation, meeting our five-year **leverage goal**, investing in Global eCommerce, and continuing to strengthen our company's compliance organization."

> **Note:** When the CEO refers to "leverage," he doesn't mean financial leverage (liabilities divided by assets). Rather he is referring to **expense leverage**, which means generating more revenues for each dollar of expense. For example, getting more revenues for each dollar of advertising expense.

"Our leverage teams are working across our businesses to drive incremental benefits for the Company. We're **investing in price** to drive greater sales volume that comes from building customer loyalty. We continue to expand initiatives such as workforce planning, on-shelf availability, and sourcing to accelerate the productivity loop. We're also reducing costs, improving productivity, and delivering smarter, more efficient operations."

> Note: "**Investing in price**" likely means decreasing product prices to increase market share (e.g., more sales at lower prices), which decreases gross margin per sales dollar.

…

"The focus of Bill and his team on cost containment has never been stronger, as Walmart U.S. leveraged operating expenses by 27 **basis points** this year. We pass the majority of these cost savings to customers every day. Our EDLP [Every Day Low Prices] promise, along with a broad assortment, is the key to driving sales. Strong merchandising, efficient operations, and thoughtful use of capital will keep Walmart U.S. strong into the future."

> **Note**: A basis point is .01% or 1/100 of 1 percent.

**Jeff Davis - Wal-Mart Stores, Inc. - EVP, Finance & Treasurer**
"For the fourth quarter of fiscal 2013, Walmart reported diluted earnings per share from continuing operations of $1.67 versus $1.51 for the fourth quarter of last year. Our fiscal 2013 fourth-quarter effective tax rate was 27.7%, which was lower than our expectations and compares to 30.9% last year. Our fourth-quarter effective tax rate benefited from a number of discrete tax items, including the positive impact from fiscal 2013 legislative changes, most notably the American Taxpayer Relief Act of 2012."
…
"With respect to comp sales [comparable sales], total U.S. comp sales, without fuel, increased 1.2% for the 13-week period ended Jan. 25."

> **Note**: Some of Walmart's businesses, including Sam's Club, sell a significant amount of fuel each year. The price of fuel and thus related revenues can vary greatly, which can distort overall sales figures. This is the reason Walmart reports comps without fuel.

"For the quarter, operating expenses as a percentage of sales were 18.3%, an increase of 11 basis points.
…
"Although we were unable to offset the 11 basis point increase in operating expenses, operating income grew 2.4% to $8.6 billion. On a constant currency basis, operating income would have increased 1.4% to $8.5 billion."
…
"For the 52-week period ended Jan. 25, U.S. comp sales, without fuel, increased 2.1%. While our gross profit grew 4.5%, our gross profit rate declined 12 basis points to 24.4%, which reflects our ongoing investment in price, as well as our global merchandise mix. With respect to consolidated operating expenses, the Company leveraged expenses by 14 basis points, which adequately covered the 12 basis point investment in gross profit rate. This is the third consecutive year that our company leveraged operating expenses."
…

"Turning to our balance sheet, consolidated inventory grew 7.6%, driven primarily by our U.S. operations. You'll hear more from the segment CEOs regarding the individual drivers of inventory growth."

**Bill Simon - Wal-Mart Stores, Inc. - President & CEO, Walmart U.S.**
"Our customers continue to rely on us to deliver Every Day Low Prices. This is evident by our consistent gains in market share across the majority of the businesses. According to The Nielsen Company, we gained 40 basis points of market share in the measured category of food, consumables, health & wellness/OTC [over the counter sales] during the 13 weeks ended January 26, 2013. And, according to The NPD Group, for the three-month period ending December 31, 2012, we also improved market share in toys and the Walmart entertainment categories."
…
"Now, let me now recap the [US] highlights of the year. During the fiscal year, net sales increased by $10.3 billion to $274.5 billion. The growth was supported by a solid 1.8% 52-week comp."
…
"Over the course of the year, we grew our retail space by 14 million square feet. In fiscal year 2014, we plan to add between 15 million and 17 million square feet of retail space, representing between 220 and 240 total units, comprised of new stores, expansions, relocations and conversions. You've heard us say, supercenters [which include groceries] remain our primary growth vehicle, and we will continue to expand this format to drive share. During the year, we opened 129 supercenters, including new stores, expansions, relocations, and conversions. We plan to expand our supercenter fleet next year by adding approximately the same number of units."

**Doug McMillon - Wal-Mart Stores, Inc. - President & CEO, Walmart International**
"International segment net sales were $37.9 billion, up 6.9% over last year's fourth quarter. We were disappointed in our sales performance in the quarter. As we discussed previously, we opened fewer new stores in Mexico, China, and Brazil than we had originally planned during the course of the year and the cumulative impact of that was felt more in the fourth quarter. In addition, our comparable store sales in our developed markets of the U.K., Canada, and Japan were pressured and below our expectations.
The holiday season was not as strong as we had planned in several of our markets.
Operating expenses were up 7.7% and we did not leverage operating expenses due to the softness in comp sales. Operating income was $2.4 billion, up 6.1%, but growing slower than sales. Currency exchange rate fluctuations increased operating income by $78 million."

**Rosalind Brewer - Wal-Mart Stores, Inc. - President & CEO, Sam's Club**
"Our optimism, however, is tempered as sales growth slowed later during the fourth quarter, most notably during mid-December and late January and was more pronounced from our business members. Important indicators of the health of our business are traffic and add-ons from small business members. Both of these areas were soft in the fourth quarter, and we are closely monitoring them.
Additionally, as we indicated last quarter, operating income growth was challenged in the fourth quarter by our price investment initiative that will benefit Sam's Club long term, but negatively impact the short-term results.
…
"Additionally, like Walmart U.S., our Advantage members are pressured by higher payroll income taxes, ongoing unemployment, and higher gas prices. Our role at Sam's Club is to support our members by creating value for them through price investments."

**Quotes from reporters and analysts close to the time Target and Walmart hosted conference calls**

"Target is probably the closest analog to Walmart in the retail sector. Both companies operate massive big-box department stores and both have added a grocery business recently. Target has a slightly different business model though. Rather than competing solely on price, the company has opted for a strategy that relies on a mix of name brands and a more-fashionable line of house brands than can be found in a Walmart. Target shoppers tend to have a little more cash at their disposal than Walmart customers, and as such will likely feel a little bit less of the pinch from rising gas prices."

*Six Retailers could outperform Walmart, Bobby Raines, February 22, 2013,* http://www.marketintelligencecenter.com/articles/262346

"Walmart beat expectations in its latest earnings report, but offered a wary outlook for the first part of this year. Safeway also reported better-than-expected earnings Thursday. The two companies have more in common than one might think. Groceries now make up more than half Walmart's American sales.

Today's numbers look back, but the worry is about what's ahead. There's been a lot of speculation about how this year's increase in the payroll tax will impact consumer spending, but other factors will also come into play.

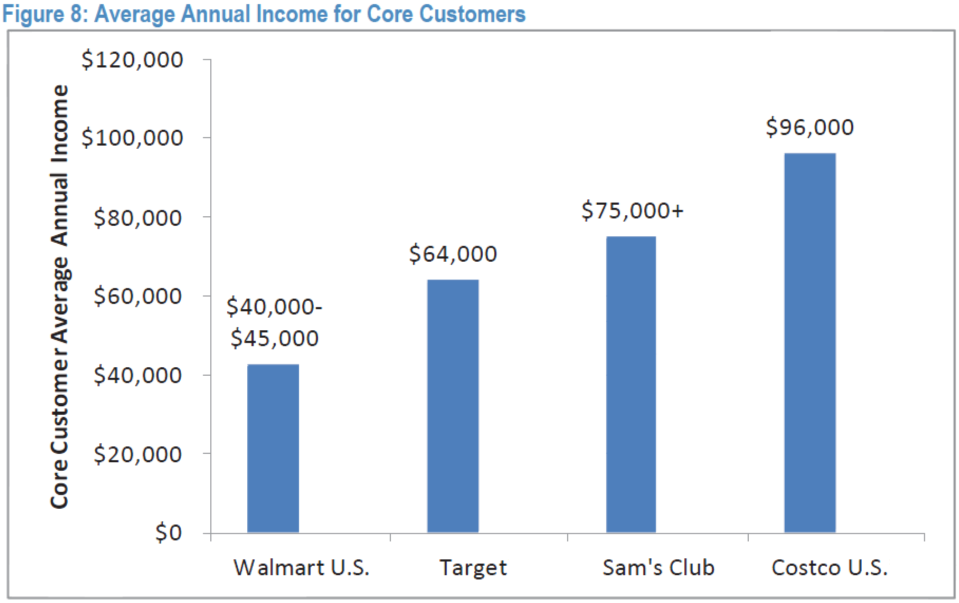
It's clear some Walmart higher-ups are worried about tightwad consumers. Bloomberg obtained leaked e-mails where a top executive called February sales "a total disaster." [These are sales in the first month of fiscal 2014 -- the next fiscal year.] Low-income shoppers are especially sensitive to the payroll tax."

*Walmart's worries: Payroll tax, gas prices, Mike Garrison, February 21, 2013,* http://www.marketplace.org/topics/business/walmart-grocers-face-more-payroll-tax

"The difficulty of continued growth given WMT's [Walmart's] size is made more challenging given current economic conditions … the consumer tends to spend in line with wage growth.

However, with an average income of ~$42,500, the 2% reduction in payroll tax cuts equates to $70/month reduction in wages. Given lower discretionary spending dollars in this income class, the impact is likely to be even larger. We believe consumers will still shop Walmart but the basket is likely to shrink and some of the more discretionary categories (e.g., apparel) suffer." [Note this report came out approximately two weeks before Walmart's conference call, which is when it announced fourth quarter results.]

Figure 8: Average Annual Income for Core Customers




*Walmart Stores Inc., Downgrading to Neutral; 2012 the Year of WMT That Was, JP Morgan, February 4, 2013*

### Excerpts from Target's Fiscal 2012 10K Annual Report

Target's fiscal 2009-2012 statements of cash flows report it paid shareholders $423, $2,452, $1,842 and $1,875 million to repurchase shares, respectively, during these years. It also reports Target paid shareholders cash dividends of $496, $609, $750, and $ 869, respectively, during these years.

Target's fiscal 2009-2012 statements of cash flows report it issued $0, $1,011, $1,994, and $1,971 million of long-term debt, respectively, during these years. It also reports Target repaid $1,970, $2,259, $3,125 and $1,529, respectively, during these years.

*Target's Inc.'s 2012 10K, page 36*

### Excerpts from Walmart's Fiscal 2013 10K Annual Report

Walmart fiscal 2010-2013 statements of cash flows report it paid shareholders $7,276, $14,776, $6,298, and $7,600 million to repurchase shares, respectively, during these years. It also reports Walmart paid shareholders cash dividends of $4,217, $4,437, $5,048, and $5,361 respectively, during these years.

Walmart fiscal 2010-2013 statements of cash flows report it issued $5,546, $11,396, $ 5,050, and $211 million of long-term debt, respectively, during these years. It also reports Walmart repaid $6,033, $ 4,080, $4,584, and $ 1,478, respectively, during these years.

*Walmart's 2013 10K, page 35*

# NAME________________________________



## Comparing Balance Sheets and Select Financial Position Ratios

Numbers below are either disclosed on the company's balance sheets with similar captions or they combine numbers with related captions.
**Note:** The calendar date for the companies' fiscal year ends are within a few days of each other; but the companies refer to the fiscal years differently, e.g. **Target's fiscal 2012** ends on February 2, 2013 and **Walmart's fiscal 2013** ends on January 31, 2013.

| | Target | | | | Walmart | | | |
|---|---|---|---|---|---|---|---|---|
| | year end | | | | year end | | | |
| | fiscal 2012 | fiscal 2011 | fiscal 2010 | fiscal 2009 | fiscal 2013 | fiscal 2012 | fiscal 2011 | fiscal 2010 |
| | 2-Feb-13 | 28-Jan-12 | 29-Jan-11 | 30-Jan-10 | 31-Jan-13 | 31-Jan-12 | 31-Jan-11 | 31-Jan-10 |
| **Assets** | USD Millions $ | | | | USD Millions $ | | | |
| Current assets | | | | | | | | |
| Cash and cash equivalents | 784 | 794 | 1,712 | 2,200 | 7,781 | 6,550 | 7,395 | 7,907 |
| Receivables | 5,841 | 5,927 | 6,153 | 6,966 | 6,768 | 5,937 | 5,089 | 4,144 |
| Inventories | 7,903 | 7,918 | 7,596 | 7,179 | 43,803 | 40,714 | 36,318 | 32,713 |
| Other current assets | 1,860 | 1,810 | 1,752 | 2,079 | 1,588 | 1,774 | 3,091 | 3,268 |
| **Total current assets** | **16,388** | **16,449** | **17,213** | **18,424** | **59,940** | **54,975** | **51,893** | **48,032** |
| Property, plant and equipment net | 30,653 | 29,149 | 25,493 | 25,280 | 116,681 | 112,324 | 107,878 | 102,307 |
| Other non-current assets | 1,122 | 1,032 | 999 | 829 | 26,484 | 26,107 | 20,892 | 20,068 |
| **Total assets** | **48,163** | **46,630** | **43,705** | **44,533** | **203,105** | **193,406** | **180,663** | **170,407** |
| **Liabilities** | | | | | | | | |
| Current liabilities | | | | | | | | |
| Accounts payable | 7,056 | 6,857 | 6,625 | 6,511 | 38,080 | 36,608 | 33,557 | 30,451 |
| Other current liabilities | 6,975 | 7,430 | 3,445 | 4,816 | 33,738 | 25,692 | 24,927 | 25,092 |
| **Total current liabilities** | **14,031** | **14,287** | **10,070** | **11,327** | **71,818** | **62,300** | **58,484** | **55,543** |
| Long-term debt (less current maturities) | 14,654 | 13,697 | 15,607 | 15,118 | 41,417 | 47,079 | 43,842 | 36,401 |
| Other noncurrent liabilities | 2,920 | 2,825 | 2,541 | 2,741 | 8,132 | 8,266 | 7,090 | 5,815 |
| **Total liabilities** | **31,605** | **30,809** | **28,218** | **29,186** | **121,367** | **117,645** | **109,416** | **97,759** |
| **Stockholders' equity** | | | | | | | | |
| Common stock (paid-in capital less treasury stock) | 3,979 | 3,543 | 3,370 | 2,981 | 3,952 | 4,034 | 3,929 | 4,181 |
| Retained Earnings | 13,155 | 12,959 | 12,698 | 12,947 | 72,978 | 68,691 | 63,967 | 66,357 |
| Accumulated other comprehensive income (loss) | (576) | (681) | (581) | (581) | (587) | (1,401) | 646 | (70) |
| Noncontrolling interests | | | | | 5,395 | 4,446 | 2,705 | 2,180 |
| **Total stockholders' equity** | **16,558** | **15,821** | **15,487** | **15,347** | 81,738 | 75,770 | 71,247 | 72,648 |
| **Total liabilities and shareholders' equity** | **48,163** | **46,630** | **43,705** | **44,533** | **203,105** | **193,415** | **180,663** | **170,407** |
| | | | | | | | | |
| **RATIOS** | | | | | | | | |
| **Level 1** | | | | | | | | |
| *Financial leverage (year-end)* | | | | | | | | |
| Liabilities/assets | 66% | 66% | 65% | 66% | 60% | 61% | 61% | 57% |
| **Level 2** | | | | | | | | |
| *Working capital* | 2,357 | 2,162 | 7,143 | 7,097 | (11,878) | (7,325) | (6,591) | (7,511) |
| Current assets - current liabilities | | | | | | | | |
| *Current ratio* | 1.17 | 1.15 | 1.71 | 1.63 | 0.83 | 0.88 | 0.89 | 0.86 |
| Current assets/ current liabilities | | | | | | | | |
| **Level 3** | | | | | | | | |
| *Common Size Balance Sheet* | | | | | | | | |
| Line item/total assets | | | | | | | | |
| **Assets** | | | | | | | | |
| Cash and cash equivalents | 2% | 2% | 4% | 5% | 4% | 3% | 4% | 5% |
| Receivables | 12% | 13% | 14% | 16% | 3% | 3% | 3% | 2% |
| Inventories | 16% | 17% | 17% | 16% | 22% | 21% | 20% | 19% |
| Other current assets | 4% | 4% | 4% | 5% | 1% | 1% | 2% | 2% |
| Total current assets | 34% | 35% | 39% | 41% | 30% | 28% | 29% | 28% |
| Property, plant and equipment net | 64% | 63% | 58% | 57% | 57% | 58% | 60% | 60% |
| Other non-current assets | 2% | 2% | 2% | 2% | 13% | 13% | 12% | 12% |
| Total assets | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| **Liabilities** | | | | | | | | |
| Accounts payable | 15% | 15% | 15% | 15% | 19% | 19% | 19% | 18% |
| Other current liabilities | 14% | 16% | 8% | 11% | 17% | 13% | 14% | 15% |
| Total current liabilities | 29% | 31% | 23% | 25% | 35% | 32% | 32% | 33% |
| Long-term debt (less current maturities) | 30% | 29% | 36% | 34% | 20% | 24% | 24% | 21% |
| Other noncurrent liabilities | 6% | 6% | 6% | 6% | 4% | 4% | 4% | 3% |
| Total liabilities | 66% | 66% | 65% | 66% | 60% | 61% | 61% | 57% |
| **Stockholders' equity** | | | | | | | | |
| Common stock (paid-in capital less treasury stock) | 8% | 8% | 8% | 7% | 2% | 2% | 2% | 2% |
| Retained Earnings | 27% | 28% | 29% | 29% | 36% | 36% | 35% | 39% |
| Accumulated other comprehensive income (loss) | -1% | -1% | -1% | -1% | 0% | -1% | 0% | 0% |
| Noncontrolling interests | 0% | 0% | 0% | 0% | 3% | 2% | 1% | 1% |
| Total stockholders' equity | 34% | 34% | 35% | 34% | 40% | 39% | 39% | 43% |
| **Total liabilities and shareholders' equity** | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| | | | | | | | | |
| **Market's perception of missed or incorrectly measured BS items** | | | | | | | | |
| *Market-to-book ratio* | | | | | | | | |
| Shares outstanding (issued - treasury) | 643.3 | 669.3 | 704.0 | 744.6 | 3,314 | 3,418 | 3,516 | 3,786 |
| Fiscal year-end price per share (historical quote) | $ 60.87 | $ 50.37 | $ 54.82 | $ 51.10 | $ 69.95 | $ 61.37 | $ 56.07 | $ 53.48 |
| Market value of stockholders' equity | 39,158 | 33,713 | 38,593 | 38,049 | 231,814 | 209,763 | 197,142 | 202,475 |
| Book value of stockholders' equity | 16,558 | 15,821 | 15,487 | 15,347 | 81,738 | 75,770 | 71,247 | 72,648 |
| Market-to-book ratio | 2.36 | 2.13 | 2.49 | 2.48 | 2.84 | 2.77 | 2.77 | 2.79 |

*Source: Companies' websites*
*See accompanying notes in annual reports.*

## Comparing Income Statements and Select Performance Ratios

Numbers below are either disclosed on the company's statements with similar captions or they combine numbers with related captions.

| | Target | | | | Walmart | | | |
|---|---|---|---|---|---|---|---|---|
| | year ended | | | | year ended | | | |
| | fiscal 2012 | fiscal 2011 | fiscal 2010 | fiscal 2009 | fiscal 2013 | fiscal 2012 | fiscal 2011 | fiscal 2010 |
| | 2-Feb-13 | 28-Jan-12 | 29-Jan-11 | 30-Jan-10 | 31-Jan-13 | 31-Jan-12 | 31-Jan-11 | 31-Jan-10 |
| **INCOME STATEMENTS** | USD Millions $ | | | | USD Millions $ | | | |
| **Net revenues** | **73,301** | **69,865** | **67,390** | **65,357** | **469,162** | **446,950** | **421,849** | **408,085** |
| Cost of goods or services sold | 50,568 | 47,860 | 45,725 | 44,062 | 352,488 | 335,127 | 314,946 | 304,444 |
| **Gross profit** | **22,733** | **22,005** | **21,665** | **21,295** | **116,674** | **111,823** | **106,903** | **103,641** |
| Other operating income and (expenses) | 17,362 | 16,683 | 16,413 | 16,622 | 88,873 | 85,265 | 81,361 | 79,639 |
| **Operating profit** | **5,371** | **5,322** | **5,252** | **4,673** | **27,801** | **26,558** | **25,542** | **24,002** |
| Other income and (expenses) | 762 | 866 | 757 | 801 | 2,064 | 2,160 | 2,004 | 1,884 |
| **Profit before taxes** | **4,609** | **4,456** | **4,495** | **3,872** | **25,737** | **24,398** | **23,538** | **22,118** |
| Income tax refund (expense) | 1,610 | 1,527 | 1,575 | 1,384 | 7,981 | 7,944 | 7,579 | 7,156 |
| **Net profit (loss) from continuing operations** | **2,999** | **2,929** | **2,920** | **2,488** | **17,756** | **16,454** | **15,959** | **14,962** |
| **SELECTED FINANCIAL DATA** | | | | | | | | |
| (controlling and non-controlling) | | | | | | | | |
| **Comprehensive Income** | **3,104** | **2,829** | **2,920** | **2,463** | **18,768** | **13,605** | **17,968** | **17,611** |
| Beginning total assets | 46,630 | 43,705 | 44,533 | | 193,406 | 180,663 | 170,407 | |
| Ending total assets | 48,163 | 46,630 | 43,705 | 44,533 | 203,105 | 193,406 | 180,663 | 170,407 |
| **Average total assets** | **47,397** | **45,168** | **44,119** | | **198,256** | **187,035** | **175,535** | |
| (beginning + ending total assets)/2 | | | | | | | | |
| Beginning owner's equity | 15,821 | 15,487 | 15,347 | | 75,770 | 71,247 | 72,648 | |
| Ending owner's equity | 16,558 | 15,821 | 15,487 | 15,347 | 81,738 | 75,770 | 71,247 | 72,648 |
| **Average owners' equity** | **16,190** | **15,654** | **15,417** | | **78,754** | **73,509** | **71,948** | |
| (beginning + ending owner's equity)/2 | | | | | | | | |
| **RATIOS** | | | | | | | | |
| **Level 1: Comprehensive income** | | | | | | | | |
| *Return-on-equity-Comprehensive Income (ROE-CI)* | 19.17% | 18.07% | 18.94% | | 23.83% | 18.51% | 24.97% | |
| CI/average owners' equity | | | | | | | | |
| **Level 2: Major categories** | | | | | | | | |
| *Return-on-equity (ROE)* | 18.52% | 18.71% | 18.94% | | 22.55% | 22.38% | 22.18% | |
| net profit/average owner's equity | | | | | | | | |
| **Level 3: Significant Subcategories--DuPont Model** | | | | | | | | |
| Profit margin ratio | 6.29% | 6.38% | 6.67% | 5.92% | 5.49% | 5.46% | 5.58% | 5.42% |
| profit before taxes/revenue | | | | | | | | |
| Asset turnover | 1.55 | 1.55 | 1.53 | | 2.37 | 2.39 | 2.40 | |
| revenue/average total assets | | | | | | | | |
| Financial leverage | 2.93 | 2.89 | 2.86 | | 2.52 | 2.54 | 2.44 | |
| average total assets/average owners' equity | | | | | | | | |
| Income tax factor | 0.65 | 0.66 | 0.65 | 0.64 | 0.69 | 0.67 | 0.68 | 0.68 |
| 1- (tax expense/pretax income) | | | | | | | | |
| **Level 4: Line items** | | | | | | | | |
| *Common size income statements:* | Percent of revenues | | | | Percent of revenues | | | |
| Net revenues | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% |
| Cost of goods or services sold | 68.99% | 68.50% | 67.85% | 67.42% | 75.13% | 74.98% | 74.66% | 74.60% |
| Gross profit margin | 31.01% | 31.50% | 32.15% | 32.58% | 24.87% | 25.02% | 25.34% | 25.40% |
| Other operating income and (expenses) | 23.69% | 23.88% | 24.36% | 25.43% | 18.94% | 19.08% | 19.29% | 19.52% |
| Operating profit margin | 7.33% | 7.62% | 7.79% | 7.15% | 5.93% | 5.94% | 6.05% | 5.88% |
| Other income and (expenses) | 1.04% | 1.24% | 1.12% | 1.23% | 0.44% | 0.48% | 0.48% | 0.46% |
| Profit margin before taxes | 6.29% | 6.38% | 6.67% | 5.92% | 5.49% | 5.46% | 5.58% | 5.42% |
| Income tax expense | 2.20% | 2.19% | 2.34% | 2.12% | 1.70% | 1.78% | 1.80% | 1.75% |
| Net profit margin (loss) | 4.09% | 4.19% | 4.33% | 3.81% | 3.78% | 3.68% | 3.78% | 3.67% |
| *Revenue growth* | 4.92% | 3.67% | 3.11% | | 4.97% | 5.95% | 3.37% | |
| (current year-prior year)/prior year | | | | | | | | |

*Source: Companies' websites*

*See accompanying notes in the annual reports.*

## Part I: Your qualified claim and opening remarks

### Claim:

**Fill in the blank with either Target or Walmart:**

**___________________________ appears to have the better future prospects at the most recent balance sheet dates, taking into consideration expected future ROEs and risks.**

### Qualifiers:

**Put an X at the spot on the scale below that indicates the likelihood your claim is correct, given the available information and concepts covered thus far.**

After completing Parts II and III, put an X at the spot on the scale below that indicates the likelihood your claim is correct, given the available information and concepts covered thus far. Your response should depend on the strength of your arguments, counterarguments, and rebuttals to counterarguments. For example, when you conclude your arguments and counterarguments are equally strong, your X will be near the middle of the scale. By contrast, when you conclude your arguments are very strong and there are no viable counterarguments, your X will be near the right end of the scale.

Given these directions, your response should ignore the possibility that other relevant information exists that could change your arguments, counterarguments, or rebuttals, and thus the confidence you have in your claim.


*The Toulmin Method of Argumentation: The Second Triad*, Keith Green
http://www.youtube.com/watch?v=-gRaC_vZiD8

## Opening remarks:

Assume you are presenting your analysis to an audience and you have decided that your opening remarks will present your qualified claim and briefly preview the way you assess the relative strengths of your arguments, counterarguments, and rebuttals without explicitly stating them.

For example, you might state "Based on my analysis of available information, I have concluded that XX Company likely has the better future prospects at the most recent balance sheet dates, taking into consideration expected future ROEs and risks. I will present three supporting arguments for this claim, two of which are very compelling. I will also present two counterarguments. I will thoroughly refute one of these but I can't provide a reasonable rebuttal for the other, which has sufficient merit for me to qualify my claim as likely rather than probable."

**Write your opening remarks below:**

## Part II: Your arguments

Provide no more than three arguments in support of your claim in the space provided below, numbered and arranged according to your assessment of their strength (from strongest to weakest).

Consistent with The Toulmin Model, each argument should provide evidence, a warrant, and possibly backing for the warrant. You need not identify the components. For example, you needn't state here is my evidence and here is its warrant. However, both must be present for each argument and while the warrant can be implied, the evidence and backing must be explicit. Keep in mind that the quality of your response depends more on the strength of the arguments you present rather than the number of arguments. For example, one exceptional argument may be all you need.

### Arguments:

**Write your arguments below, conditional on concepts covered thus far and the provided information:**

**NAME**__________________________________

**NAME**______________________________

## Part III: Your counterarguments and rebuttals

Provide no more than three counterarguments to your claim, numbered and arranged according to your assessment of their challenge to the claim (from strongest to weakest). If possible provide rebuttals immediately below each counterargument.

### Counterarguments and rebuttals:

**Write your counterarguments and rebuttals below, conditional on concepts covered thus far and the provided information:**

**NAME**______________________________________