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Sears, Roebuck and Co. vs. Wal-Mart Stores, Inc.

Don Edwards, having just earned an MBA, decided to take a job as an analyst with a prestigious investment bank. He was assigned to a team that followed retail companies. His first task was to prepare a report that contrasted the financial performance of Sears and Wal-Mart. Although Wal-Mart was the acknowledged powerhouse of the U.S. retailing industry, Sears had made some great strides in the 1990s to revive the fortunes of its ailing stores. In fact, Edwards noted that Sears' ROE of 22% exceeded Wal-Mart's ROE of 20%, leading him to wonder which firm was the true powerhouse. Edwards knew that there was a good chance that his report would be used as input into buy/sell recommendations on these two companies so he wanted to do a good job.

Sears, Roebuck and Co.

Founded in 1891, Sears, Roebuck and Co. grew over the course of the next century to become the world's largest retailer in terms of annual sales. Originally operated solely as a catalog business, the company expanded into retail stores in 1924. Sears' stores were primarily located in shopping malls and sold a variety of merchandise including apparel, cosmetics, jewelry, electronics, household appliances, cookware, bedding, and handtools.

By the early 1980s, Sears was confronted with increased competition and declining market share. A number of different retailing initiatives as well as diversification into financial services and real estate failed to turn around the company's financial performance. In 1992, Arthur C. Martinez was brought on board to head Sears's retailing operations. He was named the company's CEO three years later.

Faced with outdated and unprofitable stores, Martinez sought to cut costs in order to improve profitability. He also re-oriented the product mix at Sears' stores in an attempt to boost sales by appealing to a target audience of middle-class female shoppers. The slogan, "Come see the softer side of Sears," reflected the company's commitment to updating its merchandise selection.

Another way that Martinez sought to improve Sears' sales figures was to offer customers more flexibility to pay for merchandise gradually over time through the use of the company's proprietary credit card. Sears' credit card was issued by the company and could only be used in its own stores.

This case was prepared by Professors Gregory S. Miller and Christopher Noe from published sources as the basis for class discussion rather than to illustrate either effective handling of an administrative situation. It is a rewritten version of the case, Sears, Roebuck and Co. vs. Wal-Mart Stores, Inc., HBS No. 199-046. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Following Martinez's lead, Sears opened 24 million new card accounts between 1993 and 1996—roughly a 50% increase over the previous four years.[1]

Exhibit 1 contains selected excerpts of the description of business from Sears 1997 10-K, **Exhibit 2** discusses several non-standard events that occurred during fiscal 1997, **Exhibit 3** consists of Sears' 1997 financial statements. **Exhibit 4** contains selected excerpts from Sears 1997 summary of significant accounting policies while **Exhibit 5** provides the fiscal 1997 lease footnote. **Exhibit 6** provides some information on the breakdown of the company's operations by business segment. Sears was split into retailing, service, and credit businesses. The retailing segment consisted of the company's namesake stores in addition to four different specialty chains that featured home furnishings, hardware, tires and batteries, and auto parts. The service segment was primarily composed of a business that performed home remodeling and appliance repair. The credit segment represented all activities related to Sears' credit card. **Exhibit 7** supplies further detail on various aspects of operations for the credit segment.

Wal-Mart Stores, Inc.

In 1962, Sam Walton opened the first Wal-Mart in Bentonville, Arkansas. What began as a single store in a small rural community grew over the next three decades into a retailing powerhouse. Posting net sales of $43.9 billion in 1991, Wal-Mart claimed the title of world's largest retailer. Continuing on a track of tremendous growth, the company was able to break $100 billion in annual net sales just five years later.

Besides Wal-Mart's namesake discount stores, the company also operated Sam's Club membership warehouses and Wal-Mart Supercenters. Wal-Mart's pledge to provide a competitive price on anything that it sold was reflected in the slogan, "Always low prices."

Beginning in 1996, a Wal-Mart customer could obtain a MasterCard with the company's logo on it. However, this credit card was issued by Chase Manhattan Bank, which completely bore the risk of a user either making late payments or failing to pay off a balance altogether. Unlike Sears, Wal-Mart did not have a proprietary credit card.

Exhibit 8 consists of selected excerpts from the description of business in Wal-Mart's 1997 10-K. **Exhibit 9** consists of Wal-Mart's financial statements for the 1997 fiscal year.[2] **Exhibit 10** provides selected excerpts from a summary of Wal-Mart's significant accounting policies while **Exhibit 11** contains the 1997 lease footnote.

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[1] Robert Brenner, "Come See the Softer Side of Sears—Its Earnings," *The Wall Street Journal*, July 23, 1998.

[2] Wal-Mart follows a common retail convention of ending its fiscal year on January 31 of the following calendar year. This allows the year end to capture all holiday sales and related returns to the stores. Thus, fiscal 1997 ends on January 31, 1998. Sears does not follow this convention.

Exhibit 1 Selected Excerpts Sears, Roebuck and Co., 1997 Description of Business

Credit

The products offered by the Company's domestic credit operations ("Credit") make it more attractive for customers to purchase goods and services from the Retail and Services businesses. As of December 1997, Credit had approximately 27.0 million active customer credit accounts (accounts with balances as of the beginning or end of December 1997) with an average balance of $1,058. Sears Card, the traditional charge card, accounted for approximately 90% of total receivables. There were approximately 41 million Sears Card customers with accounts that were active during any month in 1997.

Sears stores also accept third party credit and debit cards such as VISA, MasterCard, American Express and Discover Card. Sears Card as a percentage of total sales in the Full-line and the majority of the specialty store formats was approximately 55.1%, 56.6%, and 56.6% for fiscal years 1997, 1996, and 1995, respectively. Since August 1, 1993, when Sears began to accept VISA, MasterCard and American Express cards at all Sears stores, the Company has focused intensely on marketing and other initiatives that are designed to maintain the penetration of Credit products in all sales and service channels, as well as to increase the revenues of the Retail and Services businesses.

Sears has an ongoing securitization program through which a portion of domestic customer receivable balances are sold through SRFG, Inc., a wholly-owned subsidiary, to a master trust (the "Master Trust") that issues credit account pass-through certificates to public and private investors. The receivables represented by the pass-through certificates sold to third parties qualify as sales for financial statement purposes and as such the receivables are removed from the consolidated balance sheet. The balance of the receivables in the Master Trust, which are not sold to third parties, is presented as retained interest in transferred credit card receivables. Pursuant to contractual agreements, Sears remains the servicer on the accounts and receives a fee for the services performed.

Properties

The following table sets forth information concerning stores operated by Domestic Operations.

	Full-line	Auto Stores			Home Stores			
	Stores	Tires	Parts	HomeLife	Hardware	Dealer	Other	Total
Stores at January 3, 1998:	460	598	129	31	13	2	18	1,251
Leased								
Operating Leases	325	491	486	58	228	--	26	1,614
Capital Leases	48	17	--	12	14	--	--	91
Independently owned and operated Dealer stores	--	--	--	--	--	574	--	574
Total stores at fiscal year-end 1994	800	1,007	384	72	80	285	70	2,698
Stores opened during fiscal 1995	16	37	215	26	45	98	7	444
Stores closed during fiscal 1995	(10)	(13)	(17)	(1)	(17)	(8)	(6)	(72)
1995	806	1,031	582	97	108	375	71	3,070
Stores opened during fiscal 1996	27	40	67	12	136	120	9	411
Stores closed during fiscal 1996	(12)	(13)	(22)	(2)	(15)	(26)	(20)	(110)
1996	821	1,058	627	107	229	469	60	3,371
Stores opened during fiscal 1997	21	68	90	3	33	124	--	339
Stores closed during fiscal 1997	(9)	(20)	(102)	(9)	(7)	(17)	(16)	(180)
1997	833	1,106	615	101	255	576	44	3,530
Gross retail area at fiscal year end (square feet in millions)								
1997	110.3	15.9	6.6	3.6	8.2	4.7	1.7	151.0
1996	108.4	15.2	6.9	3.8	6.1	3.8	2.0	146.2
1995	105.6	15.0	6.4	3.4	2.0	2.9	2.0	137.3
Retail selling area at fiscal year end (square feet in millions)								
1997	71.9	2.2	4.7	3.0	6.5	3.1	1.3	92.7
1996	69.9	2.1	4.7	3.2	5.6	2.6	1.5	89.8
1995	66.8	2.1	4.5	2.9	1.7	1.9	1.5	81.4

Retail Store Revenues per Selling Square Foot

1997	1996	1995
$318	$321	$323

Exhibit 2 Sears, Roebuck and Co., 1997 Non-Comparable Items

Earnings millions, except per share after-tax per share Income from continuing operations in 1997 declined 6.6% to $1.19 billion, or $2.99 per share, from $1.27 billion, or $3.12 per share for 1996. Results for 1997 were impacted by several significant noncomparable items, which in the aggregate lowered net income by $115 million. The most notable of these items include the cost relating to the Company's handling of certain credit reaffirmation agreements, the gain on the sale of the Advantis data services business, and the positive effect from the adoption of Statement of Financial Accounting Standards (SFAS) No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," effective Jan. 1, 1997.

The effect of these and other noncomparable items is summarized as follows:

1997 Net income before noncomparable items	$1,303	$ 3.27
Reaffirmation charge	(320)	(0.80)
SFAS No. 125 accounting change	136	0.35
Sale of Advantis	91	0.23
Other	(22)	(0.06)
1997 Net income as reported	$1,188	$ 2.99

The reaffirmation charge of $475 million ($320 million after-tax) represents the estimated cost of the settlement of certain lawsuits and investigations by regulatory agencies that alleged that the Company had violated the United States Bankruptcy Code and consumer protection laws in various states through activities related to certain debt reaffirmation agreements. This estimate is based on management's assumptions as to the ultimate outcome of future events and uncertainties. Actual results could differ from this estimate and there can be no assurance that additional costs will not be incurred.

SFAS No. 125 requires the recognition of gains and losses on credit card securitizations that qualify as sales. The statement also indicates that an allowance for uncollectible accounts should not be maintained for securitized receivables that are sold. Implementation of SFAS No. 125 provided incremental net income of $136 million in 1997 and reduced reported credit revenues, selling and administrative expense and the provision for uncollectible accounts by $321 million, $126 million and $417 million, respectively.

In 1997, the Company sold its 30% equity interest in Advantis, a joint venture between IBM and the Company, to IBM, which resulted in a pretax gain of $150 million ($91 million after-tax) recorded in other income.

Other noncomparable items in 1997 include a loss on the sale of Sears Mexico, which is further discussed in the international segment, a one-time gain related to postretirement life insurance benefit plan changes, and a charge to complete the conversion of the Western Auto operations to the Parts America format.

In 1997, the Company announced changes to its postretirement life insurance benefit plan. Retiree life insurance benefits were eliminated for all active associates not retired by Dec. 31, 1997. This plan change resulted in a one-time gain of $61 million ($37 million after-tax) recorded as a reduction of selling and administrative expense. In connection with the elimination of retirement life insurance benefits for active associates, the Company also announced the reduction over a ten year period in the death benefit for certain retirees, which will generate annual after-tax savings of approximately $35 million.

The Company accelerated its plan to complete the conversion of Western Auto operations to the new Parts America format in 1997 and, as a result, recorded a charge of $38 million ($23 million after-tax) related to this initiative. As of year-end, the Company has substantially completed its conversion to the parts-only format consisting of 576 domestic Parts America stores.

In 1997, net income before noncomparable items was $1.30 billion, an increase of 4.8% per share to $3.27, from 1996. The improved profitability of the domestic retail and services businesses, coupled with strong Sears Canada performance, was largely offset by a decline in credit results due to an increase in the domestic provision for uncollectible accounts, reflecting the continuing trend of increased delinquencies and charge-offs.

Net income in 1996 was $1.27 billion, an increase of 23.3% per share to $3.12, compared to income from continuing operations of $1.03 billion, or $2.53 per share, for 1995. The increase was a result of strong merchandise sales and improved margins coupled with higher credit operating income.

Source: Sears, Roebuck and Co. 1997 10-K filing.

Exhibit 3 Sears, Roebuck and Co., 1997 Financial Statements

Statements of Income (millions fiscal years ended December 31)

	1997	1996	1995
Revenues			
Merchandise sales and services	$36,371	$33,751	$31,133
Credit revenues	4,925	4,313	3,702
Total revenues	41,296	38,064	34,835
Costs and expenses			
Cost of sales, buying and occupancy	26,769	24,889	23,160
Selling and administrative	8,331	8,059	7,428
Provision for uncollectible accounts	1,532	971	589
Depreciation and amortization	786	697	580
Interest	1,409	1,365	1,373
Reaffirmation charge	475	--	--
Total costs and expenses	39,302	35,981	33,130
Operating income	1,994	2,083	1,705
Other income	106	22	23
Income before income taxes	2,100	2,105	1,728
Income taxes	912	834	703
Income from continuing operations	1,188	1,271	1,025
Discontinued operations	--	--	776
Net income	$1,188	$1,271	$1,801

Exhibit 3 (continued)

Balance Sheets (millions fiscal years ended December 31)

	1997	1996
Assets		
Current assets		
Cash and cash equivalents	$358	$660
Retained interest in transferred credit card receivables	3,316	2,260
Credit card receivables	20,956	20,104
Less: Allowance for uncollectible accounts	1,113	801
	19,843	19,303
Other receivables	335	335
Merchandise inventories	5,044	4,646
Prepaid expenses and deferred charges	956	348
Deferred income taxes	830	895
Total current assets	30,682	28,447
Property and equipment		
Land	487	445
Buildings and improvements	5,420	5,080
Furniture, fixtures and equipment	4,919	4,279
Capitalized leases	498	433
	11,324	10,237
Less accumulated depreciation	4,910	4,359
Total property and equipment, net	6,414	5,878
Deferred income taxes	666	905
Other assets	938	937
Total assets	$38,700	$36,167
Liabilities		
Current liabilities		
Short-term borrowings	$5,208	$3,533
Current portion of LT debt and capitalized lease obligations	2,561	2,737
Accounts payable and other liabilities	6,637	7,225
Unearned revenues	830	840
Other taxes	554	615
Total current liabilities	15,790	14,950
Long-term debt and capitalized lease obligations	13,071	12,170
Postretirement benefits	2,564	2,748
Minority interest and other liabilities	1,413	1,354
Total liabilities	32,838	31,222
Shareholders' equity		
Common shares ($.75 par value, 1,000 shares authorized 390.9 and 391.4 shares outstanding)	323	323
Capital in excess of par value	3,598	3,618
Retained income	4,158	3,330
Treasury stock-at cost	(1,702)	(1,655)
Minimum pension liability	(217)	(277)
Deferred ESOP expense	(204)	(230)
Cumulative translation adjustments	(94)	(164)
Total shareholders' equity	5,862	4,945
Total liabilities and shareholders' equity	$38,700	$36,167

Exhibit 3 (continued)

Statements of Cash Flows (millions fiscal years ended December 31)

	1997	1996	1995
Cash flows from operating activities			
Net income	$1,188	$1,271	$1,801
Adjustments to reconcile net income to net cash provided by (used in) operating activities			
Depreciation, amortization and other non-cash items	807	774	631
Provision for uncollectible accounts	1,532	971	589
Gain on sales of property and investments	(122)	(36)	(35)
Change in (net of acquisitions):			
Deferred income taxes	273	(31)	50
Retained interest in transferred credit card receivables	(1,056)	3,318	(2,036)
Credit card receivables	(2,285)	(5,739)	(534)
Merchandise inventories	(475)	(475)	30
Other operating assets	(160)	111	(106)
Other operating liabilities	(258)	1,025	801
Discontinued operations	--	--	(776)
Net cash (used in) provided by operating activities	(556)	1,189	415
Cash flows from investing activities			
Acquisition of businesses, net of cash acquired	(138)	(296)	(53)
Proceeds from sales of property and investments	394	42	41
Purchases of property and equipment	(1,328)	(1,189)	(1,183)
Discontinued operations	--	--	483
Net cash used in investing activities	(1,072)	(1,443)	(712)
Cash flows from financing activities			
Proceeds from long-term debt	3,920	4,683	2,588
Repayments of long-term debt	(3,299)	(1,832)	(1,124)
Increase (decrease) in short-term borrowings, primarily 90 days or less	1,834	(1,814)	(637)
Termination of interest rate swap agreements	(633)	--	--
Repayments of ESOP loan	16	21	44
Preferred stock redemption	--	(325)	--
Common shares purchased for employee stock plans	(170)	(164)	--
Common shares issued for employee stock plans	103	134	97
Dividends paid to shareholders	(441)	(394)	(607)
Net cash provided by financing activities	**1,330**	**309**	**361**
Effect of exchange rate changes on cash and cash equivalents	**(4)**	**(1)**	**(6)**
Net (decrease) increase in cash and cash equivalents	**(302)**	**54**	**58**

Source: Sears, Roebuck and Co. 1997 Annual Report.

Exhibit 4 Selected Excerpts Sears, Roebuck and Co., 1997 Summary of Significant Accounting Policies

1. Summary Of Significant Accounting Policies Basis Of Presentation

The consolidated financial statements include the accounts of Sears, Roebuck and Co. ("the Company") and all significant domestic and international companies in which the Company has more than a 50% equity ownership. Investments in companies in which the Company has a 20% to 50% ownership are accounted for using the equity method. The Allstate Corporation ("Allstate") and Homart Development Co. and affiliated entities ("Homart") are presented as discontinued operations in 1995.

Merchandise Sales And Services

Revenues from merchandise sales and services are net of returns and allowances and exclude sales tax. Included in merchandise sales and services are gross revenues from licensees of $1.39, $1.32 and $1.25 billion for 1997, 1996 and 1995, respectively.

Service Contracts

The Company sells extended service contracts with terms of coverage generally between 12 and 36 months. Revenue and incremental direct acquisition costs from the sale of these contracts are deferred and amortized on a straight-line basis over the lives of the contracts. Costs related to servicing the contracts are expensed as incurred.

Store Pre-Opening Expenses

Costs associated with the opening of new stores are expensed as incurred.

Retained Interest In Transferred Credit Card Receivables

As part of its domestic credit card securitizations, the Company transfers credit card receivables to a Master Trust ("Trust") in exchange for certificates representing undivided interests in such receivables. Effective Jan. 3, 1998 the Company reclassified, for all periods presented, its retained interest in transferred credit card receivables to a separate balance sheet account and presented the related charge-offs of transferred credit card receivables as a reduction of credit revenues. The retained interests consist of investor certificates held by the Company and the seller's certificate, which represents both contractually required seller's interest and excess seller's interest in the credit card receivables in the Trust. Retained interests are as follows:

Millions	1997	1996	1995
Investor certificates held by the Company	$ 545	$ 522	$ 295
Contractually required seller's interest	697	684	495
Excess seller's interest	2,074	1,054	4,789
Retained interest in transferred credit card receivables	$3,316	$2,260	$5,579

The Company intends to hold the investor certificates and contractually required seller's interest to maturity. The excess seller's interest is considered available for sale. Due to the short-term revolving nature of the underlying credit card receivables, the carrying value of the Company's retained interest in transferred credit card receivables approximates fair value and is classified as a current asset.

Credit Card Receivables

Credit card receivables arise primarily under open-end revolving credit accounts used to finance purchases of merchandise and services offered by the Company. These accounts have various billing and payment structures, including varying minimum payment levels and finance charge rates. Based on historical payment patterns, the full receivable balance will not be realized within one year.

Credit card receivables are shown net of an allowance for uncollectible accounts. The Company provides an allowance for uncollectible accounts based on impaired accounts, historical charge-off patterns, and management judgment.

Uncollectible accounts are generally charged off automatically when the customer's past due balance is eight times the scheduled minimum monthly payment, except that accounts may be charged off sooner in the event of customer bankruptcy. Finance charge revenue is recorded until such time as an account is charged off. Finance charges on charged-off accounts are presented as a reduction of credit revenues.

Effective for fiscal year 1997, the Company adopted SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 125 requires that the Company recognize gains on its domestic credit card securitizations which qualify as sales and that an allowance for uncollectible accounts not be maintained for receivable balances which are sold. Prior to adoption of SFAS No. 125, the Company maintained an allowance for uncollectible sold accounts as a recourse liability and did not recognize gains on securitizations. Adoption of SFAS No. 125 increased net income $136 million in 1997.

Merchandise Inventories

Approximately 83% of merchandise inventories are valued at the lower of cost (using the last-in, first-out or LIFO method) or market using the retail method. To estimate the effects of inflation on inventories, the Company utilizes internally developed price indices.

The LIFO adjustment to cost of sales was a credit of $17 million in 1997 and a charge of $19 million in 1996 and 1995. Partial liquidation of merchandise inventories valued under the LIFO method resulted in credits of $2 million and $15 million in 1997 and 1995. No layer liquidation credits resulted in 1996. If the first-in, first-out (FIFO) method of inventory valuation had been used instead of the LIFO method, merchandise inventories would have been $713 and $730 million higher at Jan. 3, 1998 and Dec. 28, 1996, respectively.

Merchandise inventories of international operations, the Parts Group, certain Sears Tire Group formats and Puerto Rico, which represent approximately 17% of merchandise inventories, are recorded at the lower of cost or market based on the FIFO method.

Property And Equipment

Property and equipment is stated at cost less accumulated depreciation. Depreciation is provided principally by the straight-line method over the estimated useful lives of the related assets, generally 5 to 10 years for furniture, fixtures and equipment, 40 to 50 years for buildings and building improvements, and over the expected term of the lease or estimated useful lives, whichever is shorter, for leasehold improvements.

Goodwill

Included in other assets is the excess of purchase price over net assets of businesses acquired ("goodwill"), which is amortized using the straight-line method over 40 years.

Exhibit 5 Sears, Roebuck and Co., Leased Stores Footnote

Lease And Service Agreements

The Company leases certain stores, office facilities, warehouses, computers and transportation equipment.

Operating and capital lease obligations are based upon contractual minimum rates and, for certain stores, amounts in excess of these minimum rates are payable based upon specified percentages of sales. Certain leases include renewal or purchase options. Operating lease rentals were $439, $365 and $357 million, including contingent rentals of $57, $66 and $66 million, for the years ended Jan. 3, 1998, Dec. 28, 1996, and Dec. 30, 1995, respectively.

Minimum lease obligations, excluding taxes, insurance and other expenses payable directly by the Company, for leases in effect as of Jan. 3, 1998, were:

	Capital Leases (millions)	Operating Leases (millions)
1998	$ 59	$ 340
1999	58	311
2000	58	268
2001	57	235
2002	53	210
After 2002	765	1,102
Total minimum payments	$1,050	$2,466
Less imputed interest	626	
Present value of minimum lease payments	424	
Less current maturities	14	
Long-term obligation	$ 410	

The Company has committed to purchase from a third party provider data and voice networking and information processing services of at least $216 million annually through 2004. Total expenses incurred by the Company for these services during the years 1997, 1996 and 1995 were $361, $327 and $270 million, respectively.

Source: Sears, Roebuck and Co. 1997 10-K filing.

Exhibit 6 Sears, Roebuck and Co., 1995-97 Operating Income by Business Format (millions)

Fiscal years ended December 31,

	1997	1996	1995
Retail	$946	$867	$703
Services	345	279	221
Credit	1,005	1,164	1,001
Corporate	(214)	(216)	(197)
Total operating income	$2,082	$2,094	$1,728

Source: Sears, Roebuck and Co. 1997 Annual Report.

Exhibit 7 Sears, Roebuck and Co., 1995-97 Credit Segment Information, Fiscal years ended December 31,

	1997	1996	1995
Sears Card as % of sales	55.1%	56.6%	56.6%
Credit card receivables ($ millions)	20,956	20,104	19,193
Provision for uncollectible accounts[a] ($ millions)	1,532	971	589
Allowance for uncollectible accounts[b] ($ millions)	1,113	801	826
Delinquency as % of end-of year credit card receivables[c]	7.00%	5.40%	4.16%

Source: Sears, Roebuck and Co. 1997 Annual Report.

[a]Provision for uncollectible accounts is also commonly referred to as bad debt expense. This expense is a separate line item on the income statement and represents the amount of current-period sales that a company feels will not be collected as well as adjustments in uncollectibility from prior periods (if any).

[b]Allowance for uncollectible accounts appears on the balance sheet as a contra asset account to credit card receivables and measures the amount of credit card receivables that a company feels will not be collected. This account increases as bad debt expenses are recorded and decreases when uncollectible credit card receivables are written off.

[c]An account is generally considered delinquent when the past due balance is three times the scheduled minimum monthly payment.

Exhibit 8 Wal-Mart Stores, Inc., 1997 Description of Business

The Company, a Delaware corporation, has its principal offices in Bentonville, Arkansas. Although the Company was incorporated in October 1969, the businesses conducted by its predecessors began in 1945 when Sam M. Walton opened a franchise Ben Franklin variety store in Newport, Arkansas. In 1946, his brother, James L. Walton, opened a similar store in Versailles, Missouri. Until 1962, the Company's business was devoted entirely to the operation of variety stores. In that year, the first Wal- Mart Discount City (discount store) was opened. In fiscal 1984, the Company opened its first three Sam's Clubs, and in fiscal 1988, its first Wal-Mart Supercenter (combination full-line supermarket and discount store). In fiscal 1992, the Company began its first international initiative when the Company entered into a joint venture in which it had a 50% interest with Cifra. Our international presence has continued to expand and at January 31, 1998, we had operations in six countries and Puerto Rico.

Store Count

Fiscal Year Ended Jan 31	Wal-Mart Discount Stores			Total	Wal-Mart Supercenters		Sam's Clubs					Total Ending Balance
	Opened	Closed	Conversions[a]		Opened	Total	Opened	Closed	Total	Opened[b]	Closed	
Balance Forward				1,714		10				208		1,932
1993	159	1	24	1,848	24	34	48	0	256	207	1	2,138
1994	141	2	37	1,950	38	72	162	1	417	304	3	2,439
1995	109	5	69	1,985	75	147	21	12	426	136	17	2,558
1996	92	2	80	1,995	92	239	9	2	433	113	4	2,667
1997	59	2	92	1,960	105	344	9	6	436	81	8	2,740
1998	37	1	75	1,921	97	441	8	1	443	67	2	2,805

Net Square Footage

Fiscal Year Ended Jan 31,	Wal-Mart Discount Stores Net Additions	Total	Wal-Mart Supercenters Net Additions	Total	Sam's Clubs Net Additions	Total	Total Net Additions	Sq.Ft[c]	Sales Per Sq.Ft.
Balance Forward		128,115,368		1,914,246		23,259,348		153,288,962	
1993	19,251,060	147,366,428	4,037,493	5,951,739	7,444,530	30,703,878	30,733,083	184,022,045	325.86
1994	16,185,442	163,551,870	6,762,080	12,713,819	19,670,804	50,374,682	42,618,326	226,640,371	324.42
1995	10,109,978	173,661,848	14,087,725	26,801,544	1,335,742	51,710,424	25,533,445	252,173,816	336.10
1996	8,188,223	181,850,071	16,791,559	43,593,103	825,020	52,535,444	25,804,802	277,978,618	335.13
1997	(103,486)	181,746,585	19,661,948	63,255,051	298,692	52,834,136	19,857,154	297,835,772	337.35
1998	(2,411,149)	179,335,436	17,076,582	80,331,633	716,150	53,550,286	15,381,583	313,217,355	348.49

[a]Wal-Mart discount store locations relocated or expanded as Wal-Mart Supercenters.

[b]Total opened net of conversions of Wal-Mart discount stores to Wal-Mart Supercenters.

[c]Includes only stores and clubs that were open at least twelve months as of January 31 of the previous year.

Exhibit 9 Wal-Mart Stores, Inc., 1997 Financial Statements

Statements of Income (amounts in millions)

Fiscal years ended January 31,	1998	1997	1996
Revenues:			
Net sales	$117,958	$104,859	$93,627
Other income-net	1,341	1,319	1,146
	119,299	106,178	94,773
Costs and expenses:			
Cost of sales	93,438	83,510	74,505
Operating, selling and general administrative expenses	19,358	16,946	15,021
Interest costs:			
Debt	555	629	692
Capital leases	229	216	196
	113,580	101,301	90,414
Income before incomes taxes, minority interest and equity in unconsolidated subsidiaries	5,719	4,877	4,359
Provision for income taxes:			
Current	2,095	1,974	1,530
Deferred	20	(180)	76
	2,115	1,794	1,606
Income before minority interest and equity in unconsolidated subsidiaries	3,604	3,083	2,753
Minority interest and equity in unconsolidated subsidiaries	(78)	(27)	(13)
Net income	$3,526	$3,056	$2,740

Note: Wal-Mart follows a common retail convention of ending its fiscal year on January 31 of the following calendar year. This allows the year end to capture all holiday sales and related returns to the stores. Thus, fiscal 1997 ends on January 31, 1998. Sears does not follow this convention.

Exhibit 9 (continued)

Balance Sheets (amounts in millions)

Fiscal years ended January 31,	1998	1997
Assets		
Current assets:		
Cash and cash equivalents	$1,447	$883
Receivables	976	845
Inventories		
At replacement cost	16,845	16,193
Less LIFO reserve	348	296
Inventories at LIFO cost	16,497	15,897
Prepaid expenses and other	432	368
Total current assets	19,352	17,993
Property, plant and equipment, at cost:		
Land	4,691	3,689
Building and improvements	14,646	12,724
Fixtures and equipment	7,636	6,390
Transportation equipment	403	379
	27,376	23,182
Less accumulated depreciation	5,907	4,849
Net property, plant and equipment	21,469	18,333
Property under capital lease:		
Property under capital lease	3,040	2,782
Less accumulated amortization	903	791
Net property under capital leases	2,137	1,991
Other assets and deferred charges	2,426	1,287
Total assets	$45,384	$39,604
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$9,126	$7,628
Accrued liabilities	3,628	2,413
Accrued income taxes	565	298
Long-term debt due within one year	1,039	523
Obligations under capital leases due within one year	102	95
Total current liabilities	14,460	10,957
Long-term debt	7,191	7,709
Long-term obligations under capital leases	2,483	2,307
Deferred income taxes and other	809	463
Minority interest	1,938	1,025
Shareholders' equity		
Preferred stock ($.10 par value; 100 shares authorized, none issued)		
Common stock ($.10 par value; 5,500 shares authorized, 2,241 and 2,285 issued and outstanding in 1998 and 1997, respectively)	224	228
Capital in excess of par value	585	547
Retained earnings	18,167	16,768
Foreign currency translation adjustment	(473)	(400)
Total shareholders' equity	18,503	17,143
Total liabilities and shareholders' equity	$45,384	$39,604

Exhibit 9 (continued)

Statements of Cash Flows (amounts in millions)

Fiscal years ended January 31,	1998	1997	1996
Cash flows from operating activities			
Net income	$3,526	$3,056	$2,740
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,634	1,463	1,304
Increase in accounts receivable	(78)	(58)	(61)
(Increase)/decrease in inventories	(365)	99	(1,850)
Increase in accounts payable	1,048	1,208	448
Increase in accrued liabilities	1,329	430	29
Deferred income taxes	20	(180)	76
Other	9	(88)	(303)
Net cash provided by operating activities	7,123	5,930	2,383
Cash flows from investing activities			
Payments for property, plant and equipment	(2,636)	(2,643)	(3,566)
Proceeds from sale of photo finishing plants	--	464	--
Acquisitions	(1,865)	--	--
Other investing activities	80	111	234
Net cash used in investing activities	(4,421)	(2,068)	(3,332)
Cash flows from financing activities			
(Decrease)/increase in commercial paper	--	(2,458)	660
Proceeds from issuance of long-term debt	547	--	1,004
Net proceeds from formation of Real Estate Investment Trust (REIT)	--	632	--
Purchase of Company stock	(1,569)	(208)	(105)
Dividends paid	(611)	(481)	(458)
Payment of long-term debt	(554)	(541)	(126)
Payment of capital lease obligations	(94)	(74)	(81)
Other financing activities	143	68	93
Net cash (used in)/provided by financing activities	(2,138)	(3,062)	987
Net increase in cash and cash equivalents	564	800	38

Source: Wal-Mart Stores, Inc. 1997 Annual Report.

Exhibit 10 Wal-Mart Stores, Inc., 1997 Significant Accounting Policy Note

Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of subsidiaries.

Significant intercompany transactions have been eliminated in consolidation.

Inventories

The Company uses the retail last-in, first-out (LIFO) method for domestic Wal-Mart discount stores and Supercenters and cost LIFO for SAM'S Clubs.

International inventories are on other cost methods. Inventories are not in excess of market value.

Pre-opening costs

Costs associated with the opening of stores are expensed during the first full month of operations. The costs are carried as prepaid expenses prior to the store opening. If the Company had expensed these costs as incurred, net income would have been reduced by $2 million, $9 million and $2 million in fiscal 1998, 1997, and 1996, respectively.

Depreciation and amortization

Depreciation and amortization for financial statement purposes are provided on the straight-line method over the estimated useful lives of the various assets. For income tax purposes, accelerated methods are used with recognition of deferred income taxes for the resulting temporary differences. Estimated useful lives are as follows:

Building and improvements	5–33 years
Fixtures and equipment	5–12 years
Transportation equipment	2–5 years
Goodwill	20–40 years

Exhibit 11 Lease Note to Financial Statements

Long-term Lease Obligations

The Company and certain of its subsidiaries have long-term leases for stores and equipment. Rentals (including, for certain leases, amounts applicable to taxes, insurance, maintenance, other operating expenses and contingent rentals) under all operating leases were $596 million, $561 million and $531 million in 1998, 1997 and 1996, respectively. Aggregate minimum annual rentals at January 31, 1998, under non-cancelable leases are as follows (in millions):

Fiscal Year	Operating Leases	Capital Leases
1999	$ 404	$ 347
2000	384	345
2001	347	344
2002	332	343
2002	315	340
Thereafter	2,642	3,404
Total minimum rentals	$ 4,424	5,123
Less estimated executory costs		73
Net minimum lease payments		5,050
Less imputed interest at rates ranging from 6.1% to 14.0%		2,465
Present value of minimum lease payments		$ 2,585

Certain of the leases provide for contingent additional rentals based on percentage of sales. Such additional rentals amounted to $46 million, $51 million and $41 million in 1998, 1997 and 1996, respectively. Substantially all of the store leases have renewal options for additional terms from five to 25 years at comparable rentals.

The Company has entered into lease commitments for land and buildings for 38 future locations. These lease commitments with real estate developers provide for minimum rentals for 20 to 25 years, excluding renewal options, which if consummated based on current cost estimates, will approximate $38 million annually over the lease terms.

Source: Wal-Mart Stores 1997 10-K filing.