

## QUESTIONS

### **1. What factors can affect the composition of a company's current and long-term assets?**

Factors like business type, industry demands, working capital management, growth strategy and financing will all affect the balance between current and long-term assets in your balance sheet.

#### **1. Business Model and Industry Characteristics**

Different industries have varying requirements for current and long-term assets based on their operational nature. For instance, a retail business may maintain higher merchandise inventories and accounts receivable levels as current assets. At the same time, manufacturing companies often invest heavily in property, plant, and equipment as long-term assets. A business's model dictates its asset allocation strategy, influencing how much liquidity it needs versus how much it can invest in long-term growth.

#### **2. Operational Needs and Cash Flow Management**

Companies must balance their operational needs with cash flow requirements. For instance, businesses with cyclical sales may prefer to hold more current assets like cash and short-term investments to ensure liquidity during low-demand periods. Conversely, companies with stable cash flows might invest more in long-term assets, reflecting confidence in sustained revenue generation. Efficient cash flow management allows a company to optimize its asset composition to meet immediate and future obligations.

#### **3. Growth Strategies and Investment Opportunities**

A company's growth strategy significantly affects its asset composition. If a business is expanding, it may allocate more resources to long-term assets such as property and equipment to increase production capacity or enhance facilities. Conversely, if the focus is on immediate returns, it may prioritize current assets like cash and receivables, allowing for quick reinvestment in opportunities or returning capital to shareholders.

#### **4. Economic Environment and Market Conditions**

External economic factors also play a crucial role. In a robust economic environment, businesses may feel encouraged to invest in long-term assets to capitalize on growth opportunities. However, during economic downturns or periods of uncertainty, companies may shift their focus towards maintaining liquidity by increasing current assets. Market conditions can influence investor sentiment and affect a company's decisions regarding asset allocation.

## 5. Debt Structure

The company's debt structure affects its asset composition, particularly the balance between current and long-term liabilities. A higher proportion of short-term debt may necessitate maintaining a larger pool of current assets to ensure obligations can be met. On the other hand, companies with significant long-term debt might focus on developing long-term assets that generate consistent cash flows to meet repayment schedules. The strategy taken regarding leverage directly influences asset management.

## 7. Seasonality and Cyclicalities

- Companies with seasonal sales cycles (like retail) will see fluctuations in **inventory** and **receivables**, with higher current assets during busy periods like holidays.
- Retailers might experience higher **merchandise inventories** during peak sales seasons and lower levels during off-peak times.

### Example from Balance Sheet:

- **Current Assets:** The cash, receivables, inventories, and other current assets indicate assets convertible into cash within a year, supporting daily operations.
- **Long-term Assets:** Property, equipment, and lease assets reflect more strategic, long-term investments. Expansion plans, logistics improvements, or long-term leases might drive this.

## 2. How can a company's debt-to-equity ratio impact its creditworthiness and access to capital?

The debt-to-equity ratio is a crucial financial metric that compares a company's total liabilities to its shareholders' equity. It gives insight into the company's financial structure, risk level, and reliance on debt financing.

A higher ratio indicates the company is **financed more by debt** than equity, which can raise concerns about its ability to meet its obligations, especially during downturns. A lower ratio suggests a company is **less leveraged**, relying more on equity, which might be perceived as lower risk but could also mean slower growth due to less aggressive expansion.

**The debt-to-equity ratio** is critical in its **creditworthiness** and **ability to access capital**. A **balanced ratio**—neither too high nor too low—indicates a well-managed capital structure, enabling the company to meet its financial obligations while still investing in growth. If the ratio is too high, creditors may hesitate to lend more, and the cost of borrowing would rise. Conversely, a low ratio enhances creditworthiness and provides access to capital at favourable terms. Still, it may also signal that the company is not taking advantage of potential growth opportunities that debt financing could provide.

A company's **debt-to-equity ratio** directly impacts its creditworthiness and access to capital. A **high debt-to-equity ratio** indicates heavy reliance on debt financing, making the company riskier in the eyes of lenders and investors. This can lead to higher borrowing costs, stricter loan covenants, and potentially a downgrade in credit ratings. Access to additional capital may become more complex, as both debt and equity investors might perceive the company as less financially stable. Conversely, a **low debt-to-equity ratio** signals that the company relies more on equity, which generally improves its creditworthiness. Securing loans at favourable interest rates becomes more accessible, and investors may view the company as a safer bet. However, an overly conservative ratio may suggest the company is not taking full advantage of debt to fund growth opportunities. In summary, a balanced ratio provides better access to capital and favourable terms, while an extreme ratio—either too high or too low—can limit financial flexibility or growth potential.

3. **Debt-to-Equity Ratio: How has the debt-to-equity ratio changed over the four years? (take into consideration total liabilities and total equity) Is the company relying more on debt financing or equity financing?**

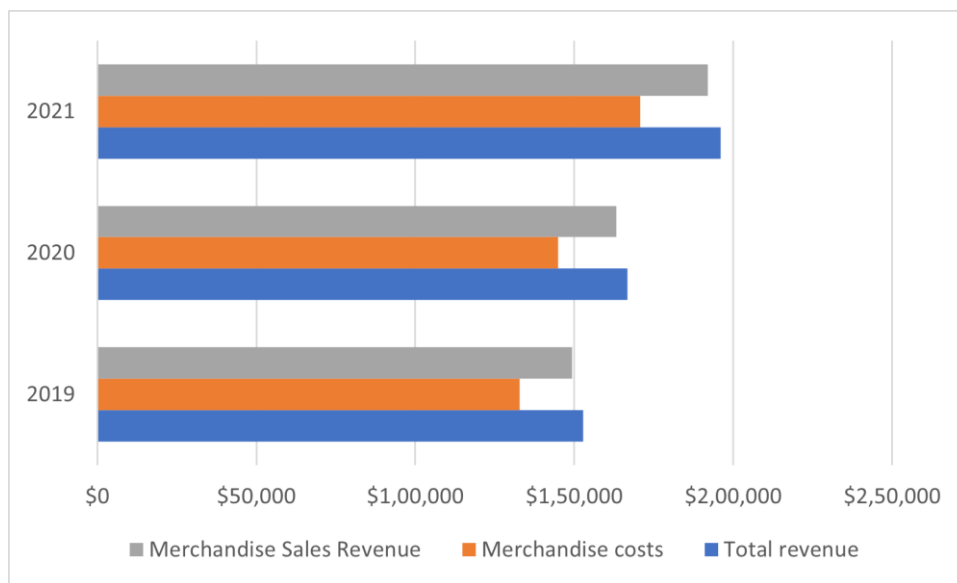


This progression indicates that the company has increasingly relied on **debt financing** rather than equity. In 2018, the company had \$2.12 in liabilities for every dollar of equity. By 2021, this had risen to \$2.28 of liabilities for every dollar of equity. While the company saw some equity growth between 2018 and 2020, the rise in total liabilities outpaced this equity growth, leading to a higher debt-to-equity ratio.

This trend suggests that the company is gradually relying more on **debt** to finance its operations and growth than raising more equity. Relying on debt financing can be beneficial in certain situations, as it may allow the company to leverage growth without diluting ownership, but it also introduces higher financial risk. A higher debt load could lead to increased interest expenses and more stringent conditions from lenders, potentially impacting long-term financial flexibility.

This increasing debt-to-equity trend over the years suggests that the company has been gradually increasing its liabilities relative to equity, which could impact its creditworthiness and access to capital. Higher ratios indicate higher risk for lenders and investors, potentially leading to higher borrowing costs and more stringent loan terms. However, a certain level of debt can also benefit growth if managed effectively.

**4. Revenue Growth: How has the company's total revenue grown over the three years? What segments are driving this growth (merchandise sales, membership fees)?**

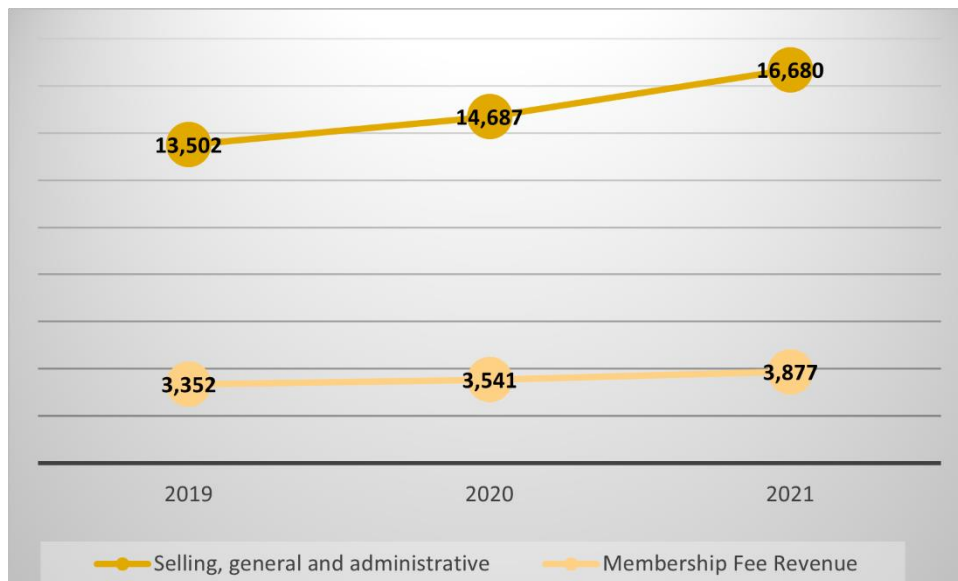


Over the three years from 2019 to 2021, the company's total revenue has grown significantly, reflecting both an increase in merchandise sales and membership fees. In **2019**, total revenue was \$152.7 billion, which grew to **\$166.8 billion** in 2020 and **\$195.9 billion** in 2021. This represents a **steady annual growth** of approximately 9.2% from 2019 to 2020 and a more substantial **17.5% growth** from 2020 to 2021.

The key segments driving this revenue growth are **merchandise sales** and **membership fee revenue**:

1. **Merchandise Sales:** This is the most significant contributor to total revenue, growing from **\$149.4 billion** in 2019 to **\$163.2 billion** in 2020, and reaching **\$192.1 billion** by 2021. Merchandise sales grew 9.3% between 2019 and 2020, and 17.7% from 2020 to 2021. This robust performance suggests strong consumer demand and possibly expanded product offerings or market penetration.
2. **Membership Fee Revenue:** While much smaller than merchandise sales, membership fees also contribute to the revenue stream and have been steadily growing. Membership fee revenue increased from **\$3.35 billion** in 2019 to **\$3.54 billion** in 2020, and reached **\$3.88 billion** in 2021. This growth in

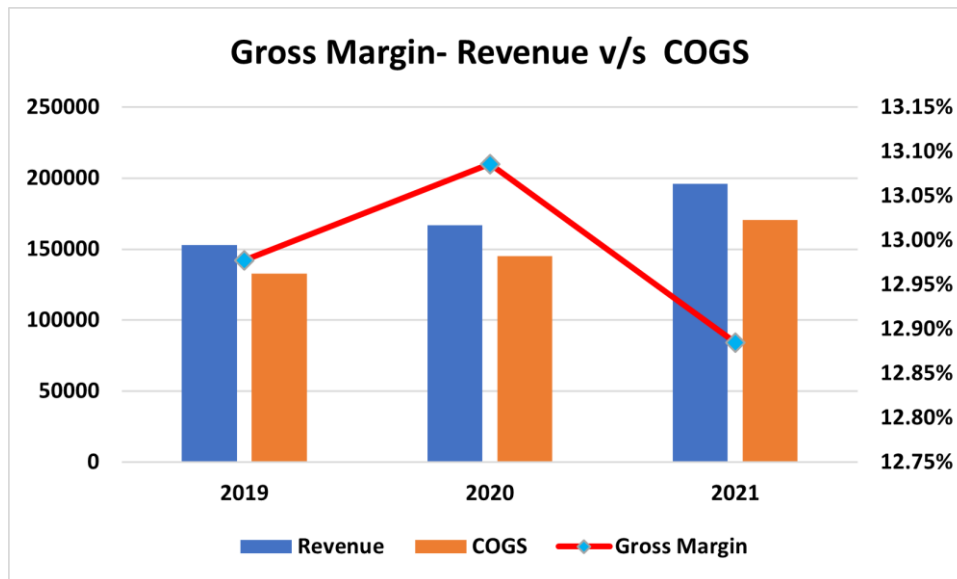
membership fees (5.6% in 2020 and 9.5% in 2021) indicates an expanding member base, which is crucial for customer loyalty and recurring revenue.



On the expense side, **selling, general, and administrative expenses (SG&A)** also grew relatively slower than total revenue. SG&A expenses increased from **\$13.5 billion** in 2019 to **\$16.7 billion** in 2021, reflecting the company's operations, staffing, and infrastructure investments to support its growing business. The growth in SG&A suggests the company is scaling operations while maintaining operational efficiency, as revenue growth outpaces the rise in these expenses.

In summary, the company's total revenue has shown robust growth driven primarily by increased merchandise sales, with a strong contribution from membership fees. This consistent revenue expansion reflects the company's ability to grow its customer base, enhance product offerings, and scale its operations effectively.

5. **Gross Margin:** Calculate and compare the gross margin (consider total revenue and total operating expense) across the three years. Is the company able to maintain or improve its margins?



Gross margin is the percentage of a company's revenue that exceeds its cost of goods sold (COGS) or operating expenses, reflecting how efficiently a company generates profit from its sales. Gross margin is essential because it shows how well a company controls its production or operating costs relative to its revenue. A higher gross margin indicates a more efficient and profitable business, allowing for better reinvestment in growth or higher profitability. Maintaining a robust gross margin is critical for tiny businesses to cover overhead costs and ensure long-term financial health.

When analyzing the trend, it is evident that while the revenue has consistently grown over the three years, the gross margin experienced fluctuations. The increase from 12.98% in 2019 to 13.09% in 2020 represents a positive development in the company's ability to manage costs effectively amidst rising sales. However, the subsequent drop to 12.88% in 2021 suggests that while the company could generate higher revenues, it faced challenges in maintaining or improving its gross margin.

In summary, the company demonstrated an ability to improve its gross margin from 2019 to 2020 but could not sustain that improvement into 2021. The overall trend shows that while the company is growing its revenues, the pressures from rising COGS have impacted its gross margin negatively in the last year analyzed.

## 6. How can investors utilize free cash flow analysis to compare different companies in the same industry?

Investors can effectively utilize free cash flow (FCF) analysis to compare different companies within the same industry by assessing the amount of cash a company generates after accounting for capital expenditures. FCF is crucial because it reflects a company's ability to generate cash, which can be used for expansion, paying dividends, reducing debt, or reinvesting in the business. Free cash flow analysis is a powerful tool for investors comparing companies within the same industry. It

provides insights into a company's financial health, growth potential, ability to manage debt, and capacity to return value to shareholders.

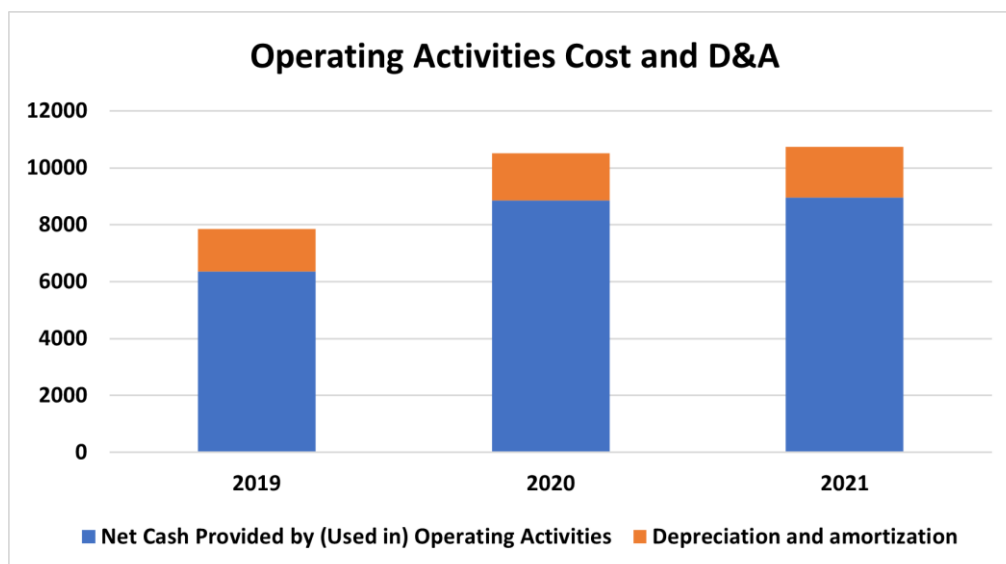
## Comparing Companies in the Same Industry

1. **Evaluating Cash Generation Efficiency:** Investors can compare the FCF of companies within the same industry to gauge their cash generation efficiency.
2. **Assessing Growth Opportunities:** Companies with robust FCF can reinvest in their operations or pursue growth opportunities more effectively. For instance, **HDFC Bank** and **ICICI Bank** are leading banks in India. If HDFC Bank shows a higher FCF than ICICI Bank, investors might view HDFC Bank as better positioned to fund expansion initiatives, improve technology infrastructure, or enhance customer services.
3. **Dividend and Debt Management:** FCF analysis helps investors understand a company's capacity to pay dividends and manage debt.
4. **Identifying Investment Risks:** Analyzing FCF can also highlight potential risks. For instance, if **Reliance Industries** has significant capital expenditures for its petrochemical division, leading to low or negative FCF, this could signal that the company is at risk of liquidity issues, particularly if it struggles to maintain profitability in the future. Investors can use this analysis to avoid companies with weak cash flow positions.

## INSIGHTS & ANALYSIS

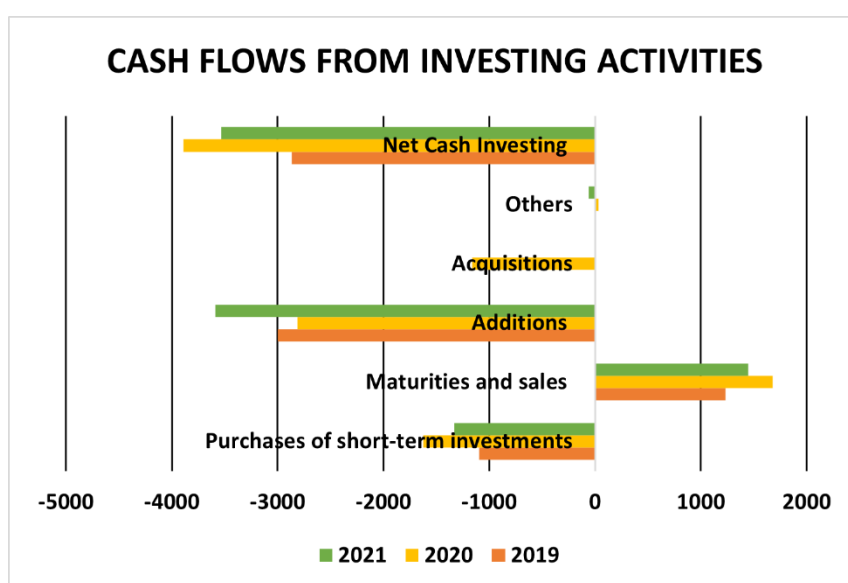
### Operating Activities:

- **Net Income Growth:** The net income, including non-controlling interests, shows consistent growth, rising from **\$3,704 million** in 2019 to **\$5,079 million** in 2021, indicating improving profitability.
- **Net Cash from Operations:** Net cash provided by operating activities increased significantly from **\$6,356 million** in 2019 to **\$8,958 million** in 2021, reflecting better cash generation. The rise in net income and positive adjustments for non-cash expenses (like depreciation and amortization) contribute to this increase.
- **Changes in Working Capital:** The changes in working capital reflect notable shifts, particularly in merchandise inventories, which saw a significant increase in cash used (from **-\$536 million** in 2019 to **-\$1,892 million** in 2021). This suggests that the company may invest more in inventory, possibly in anticipation of future sales, which could indicate growth strategies. Accounts payable increased dramatically in 2020, suggesting effective management of payables to maintain cash flow.



### Investing Activities:

- **Investments in Property and Equipment:** Cash used in investing activities remained substantial, particularly with **additions to property and equipment** increasing from **-\$2,998 million** in 2019 to **-\$3,588 million** in 2021. This consistent investment indicates a focus on growth and capacity expansion.
- **Short-term Investments:** The company also showed active management of short-term investments, with cash inflows from maturities and sales exceeding cash outflows for purchases in 2020 and 2021. This reflects a strategy to maintain liquidity while still investing in growth.
- **Acquisitions:** The acquisition expenditure in 2020 ( **-\$1,163 million**) suggests strategic growth through acquisition during that year, although no acquisitions were reported in 2019 or 2021.





## Summary of Cash Position

- **Ending Cash Balance:** The ending cash and cash equivalents remained strong at **\$11,258 million** in 2021, albeit showing a decline from **\$12,277 million** in 2020. This indicates that while the company generates significant cash from operations, its aggressive investment and financing activities consume cash reserves.
- **Net Change in Cash:** The negative net change in cash of **-\$1,019 million** in 2021, contrasted with positive changes in the previous years, highlights a potential concern about cash management or indicates a strategic use of cash for growth.

