Wal-Mart Stores Inc. international exchange exposure.

Wal-Mart Stores Inc. is the largest retailer in the world. They operate in the US and International market. Even if they did not have an international segment, they would be exposed to fluctuations in international exchange rates. More and more Wal-Mart is buying there products internationally. Their strategy as low price supplier forces them to buy products from countries that have a lower cost structure. The following is an extract from the management discussion of Annual report of 2003:

> "Wal-Mart is in the business of serving customers. In the United States, our operations are centered on operating retail stores and membership warehouse clubs. Internationally, our operations are centered on retail stores, warehouse clubs and restaurants. We have built our business by offering our customers quality merchandise at low prices."[1]

It is important to note that Wal-Mart is offering *quality merchandise*, not the highest quality, at the *low prices*, not the lowest prices. It is interesting to know that often the larger quantity packages offered by Wal-Mart are more expensive (per item) than the lower quantity packages. In other stores that is generally not the case, but consumers are generally unaware of this fact and think it is cheaper to buy lager quantity packages.

Because of Wal-Marts strategy, offering our customers quality merchandise at low prices, it is essential for Wal-Mart to control their cost. In the international market that means that Wal-Mart need to be aware of the foreign exchange rate exposure. As mentioned earlier they are exposed at the buying of goods in the international market, but also at selling in the international market. In Appendix 1 there is an overview of the sales of Wal-Mart per segment. It is clear that their International sales are the fasted growing of all the segments in the last 4 years. While the total percentage of sales stays at about 17% of the total sales. Since 1999 the International segment has grown 2.5 times in square foot

[1] Management's Discussion and Analysis, Wal-Mart Sores Inc. Annual Report 2003

(Appendix 2). All of this indicates that the foreign exchange volatility is very important to Wal-Mart Stores Inc. If we combine this with the historical *interbank* exchange rates (Appendix 3) we understand the challenge of Wal-Mart. The annual report does not report where Wal-Mart buys their products, neither does it reveal if they take any measures to protect itself from currency fluctuations at the buying site.

An additional challenge for Wal-mart is that *management also expects downward pressure on our gross margins as food sales continue to increase as a percentage of total Company sales both domestically and internationally. This trend results from the Company's program to convert many of our Wal-Mart discount stores to Supercenters, which have full-line food departments, the opening of additional Supercenters and the opening of additional Neighborhood Markets all of which result in increases in food sales as a percentage of our total net sales. Food products generally carry lower margins than general merchandise*[2]. This is a strategic decision with consequences for the cost control. If the margins get slimmer it is getting more important to control your cost and diminish fluctuations.

Wal-Mart is subject to different forms of transaction exposure. These are but not limited to:

Purchasing or selling goods internationally

Borrowing money to build stores (internationally)

Acquisition of foreign companies

Although the fluctuations in currency exchange market has positively affected the international sales segment by an aggregate of $47 million in the year 2003 Wal-Mart

[2] Wal-Mart Annual report 2003, EX-13 6 ex13final.htm, http://www.sec.gov/cgi-bin/browse-edgar?action=getcompany&CIK=0000104169&owner=include

want to diminish these fluctuations. Because in the fiscal year 2002 foreign currency exchange rates accounted for a negative aggregate of $1.1 billion. The weakening of the US$ against the United Kingdom pound and Canadian $ are the main contributors to this effect.

Wal-Mart minimizes exposure to the risk of devaluation of foreign currencies by operating in local currencies and through buying forward currency contracts, where feasible, for certain known funding requirements. The also use derivative financial instruments for purposes to reduce their exposure to fluctuations in foreign currencies and to minimize the risk and cost associated with financial and global operating activities. Generally, the contract terms of hedge instruments closely mirror those of the item being hedged, providing a high degree of risk reduction and correlation. Contracts that are highly effective at meeting the risk reduction and correlation criteria are recorded using hedge accounting.

Wal-mart routinely enters into forward currency exchange contracts in the regular course of business to manage their exposure against foreign currency fluctuations on cross-border purchases of inventory. These contracts are generally for durations of six months or less. At January 31, 2003 and 2002, they held contracts to purchase and sell various currencies with notional amounts of $185 million and $117 million, respectively, and net fair values of less than $1 million at either fiscal year. The fair values of the currency swap agreements are recorded in the consolidated balance sheets within the line "other assets and deferred charges." (See Appendix 4). The consolidated balance sheet shows an increase of $1.444 million in fair value currency swap agreements. This indicates that Wal-Mart is increasing their protection in relation to the increase of international sales. They might also be able to more accurate determine their need in foreign currency at any given time.

Wal-Mart is also vulnerable to foreign currency translation. Because they operate in many countries they have to “translate” the foreign currency into US$ for reporting purposes. The assets and liabilities of all foreign subsidiaries are translated at current exchange rates. Related translation adjustments are recorded as a component of other accumulated comprehensive income (see Appendix 5). The ineffective portion of an instrument’s change in fair value will be immediately recognized in earnings.

On the same note changes in Wal-Mart’s the International segment goodwill are the result of foreign currency exchange rate fluctuations and the addition of $197 million of goodwill resulting from the company’s Amigo acquisition. This means that foreign currency exchange rate fluctuations account for $760 million 2003 (see Appendix 6).

Besides income from sales and cost from COGS and investment Internationally Wal-Mart also has income from their suppliers. The most common of which are as follows:

Warehousing allowances – allowances provided by suppliers to compensate the Company for distributing their product through our distribution systems which are more efficient than most other available supply chains. These allowances are reflected in cost of sales when earned.

Volume discounts – certain suppliers provide incentives for purchasing certain volumes of merchandise. These funds are recognized as a reduction of cost of sales at the time the incentive target is earned.

Other reimbursements and promotional allowances – suppliers may provide funds for specific programs including markdown protection, margin protection, new product lines, special promotions, specific advertising and other specified programs. These funds are recognized at the time the program occurs and the funds are earned.

At January 31, 2003 and 2002, the Company had $286 million and $279 million respectively, in accounts receivable associated with supplier funded programs. Further, the Company had $185 million and $178 million in unearned revenue included in accrued liabilities for unearned vendor programs at January 31, 2003 and 2002, respectively.

If these suppliers are international suppliers and the products are used for the US market there is again transaction exposure. If they are supplying a local market (within the country) it might end up as translation exposure.

Wal-Mart uses derivative financial instruments for hedging and non-trading purposes to manage its exposure to interest and foreign exchange rates. Use of derivative financial instruments in hedging programs subjects Wal-Mart to certain risks, most noticeable as market and credit risks. Market risk represents the possibility that the value of the derivative instrument will change. In a hedging relationship, the change in the value of the derivative is offset to a great extent by the change in the value of the underlying hedged item. Credit risk related to derivatives represents the possibility that the counterparty will not fulfill the terms of the contract. Credit risk is monitored through established approval procedures, including setting concentration limits by counterparty, reviewing credit ratings and requiring collateral (generally cash) when appropriate. The majority of the Company's transactions are with counterparties rated A or better by nationally recognized credit rating agencies.

It is clear from this analysis that Wal-Mart is exposed to many forms of foreign currency exposure. Within the organization it seems that they have done as much as possible to prevent changes in currencies to affect the financials of the organization. Although they have implemented many protective measures it is also clear that the will not be able to protect themselves for 100% as we could see in the 2003 annual report. We have also seen in the 2004 exchange rates that the US$ is weakening against all the currencies except the Mexican Pesos and Chinese Yuan. This means that there is a likelihood that the International segment will record more sales (in $), on the other hand the COGS might be higher as well (depending on the relationship between US / International suppliers).

I have omitted the cost associated with the different protective measures, because I was not able to derive these cost from the annual report or other information. The expansion in the international market will increase the vulnerability to changes in exchange rates, but on the other hand it might help Wal-Mart to increase the use of natural hedging, currency diversification, Multinational netting, leading and/or lagging. These tools are less costly than external protection.

Appendix 1, Net Sales per segment

	Wal-Mart stores		SAM's Club		International		Other		Total company		International
Fiscal Year	Net sales	Increase	Net sales	Increase	Net sales	Increase	Net sales	Increase	Net sales	Increase	**% of total**
2003	**157,121**	12.9%	**31,702**	7.8%	**40,794**	15.0%	**14,907**	8.1%	**244,524**	**12%**	17%
2002	139,131	14.1%	29,395	9.7%	35,485	10.5%	13,788	30.8%	217,799	14%	16%
2001	121,889	12.1%	26,798	8.1%	32,100	41.2%	10,542	20.3%	191,329	16%	17%
2000	108,721	14.0%	24,801	8.4%	22,728	85.6%	8,763	23.2%	165,013	20%	14%

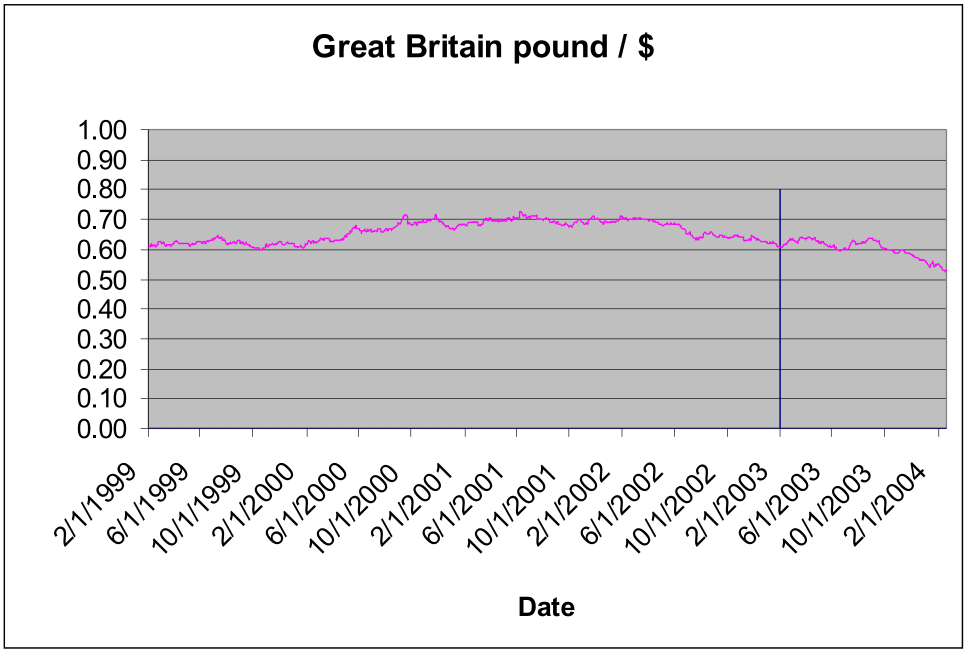
Appendix 2, Growth per sq ft in International markets

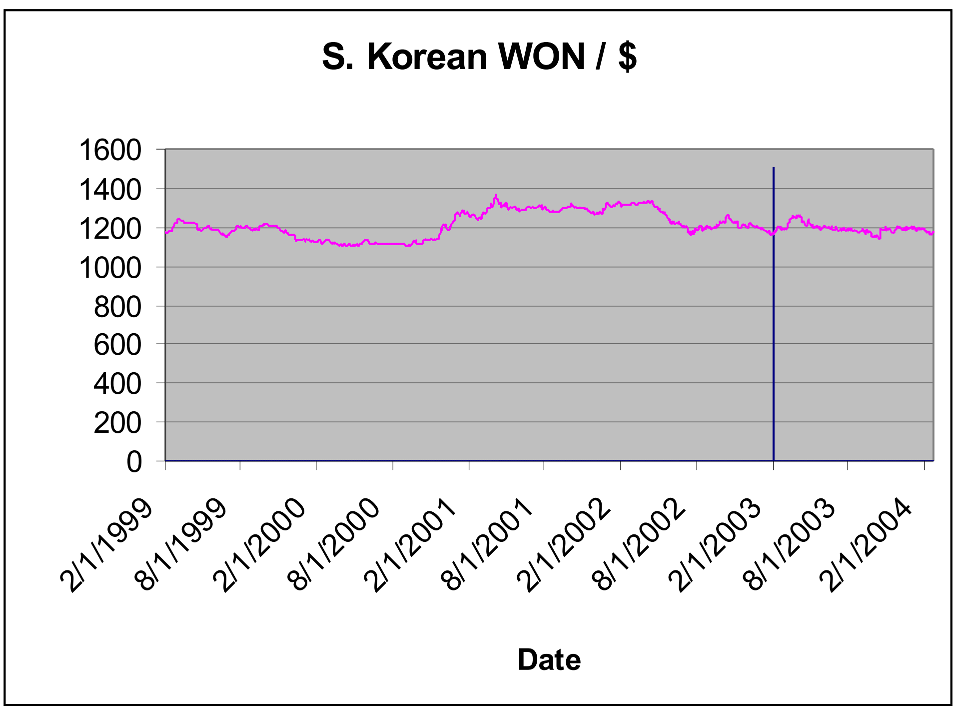
	Argentina		Brazil		Canada		China		Germany	
	Net Additions	Total	Net Additions	Total	Net Additions	Total	Net Additions	Total	Net Additions	Total
Bal forward	0	1,576,874	0	1,301,637	0	16,968,271	0	462,214	0	2,449,369
1999	663,986	2,240,860	914,618	2,216,255	981,681	17,949,532	224,827	687,041	6,845,491	9,294,860
2000	0	2,240,860	0	2,216,255	1,510,890	19,460,422	125,150	812,191	0	9,294,860
2001	(165,885)	2,074,975	818,833	3,035,088	1,019,999	20,480,421	836,701	1,648,892	(92,636)	9,202,224
2002	0	2,074,975	108,351	3,143,439	2,487,837	22,968,258	1,266,251	2,915,143	4,216,679	13,418,903
2003	0	2,074,975	0	3,143,439	1,774,046	24,742,304	1,109,834	4,024,977	(156,980)	13,261,923
Total	498,101		1,841,802		7,774,453		3,562,763		10,812,554	

	South Korea		Mexico		Puerto Rico		United Kingdom		Total	
	Net Additions	Total	Net Additions	Total	Net Additions	Total	Net Additions	Total	Net Additions	Total
Bal forward	0	0	0	17,308,450	0	1,648,340	0	0		41,715,155
1999	553,683	553,683	714,459	18,022,909	100,250	1,748,590	0	0	10,998,995	52,713,730
2000	71,042	624,725	1,696,475	19,719,384	0	1,748,590	18,825,234	18,825,234	22,228,791	74,942,521
2001	223,425	848,150	2,310,043	22,029,427	35,084	1,783,674	452,787	19,278,021	5,438,351	80,380,872
2002	849,631	1,697,781	6,904,068	28,933,495	320,555	2,104,229	942,165	20,220,186	17,095,537	97,476,409
2003	1,193,894	2,891,675	3,172,735	32,106,230	1,077,524	3,181,753	720,748	20,940,934	8,891,801	106,368,210
Total	2,891,675		14,797,780		1,533,413		20,940,934		64,653,475	

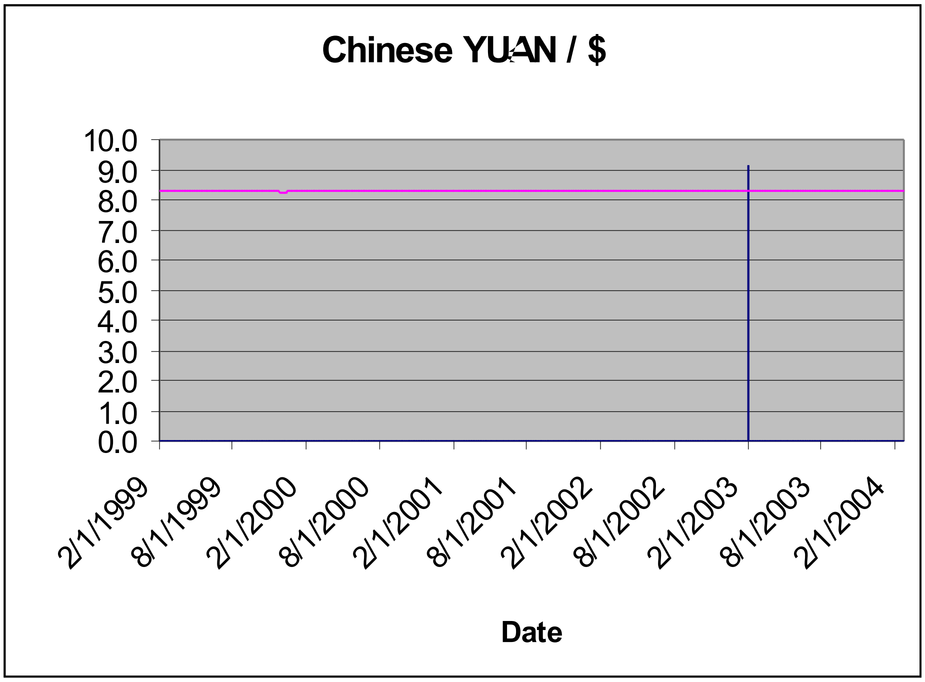
Appendix 3, Exchange rate[3] of the International markets

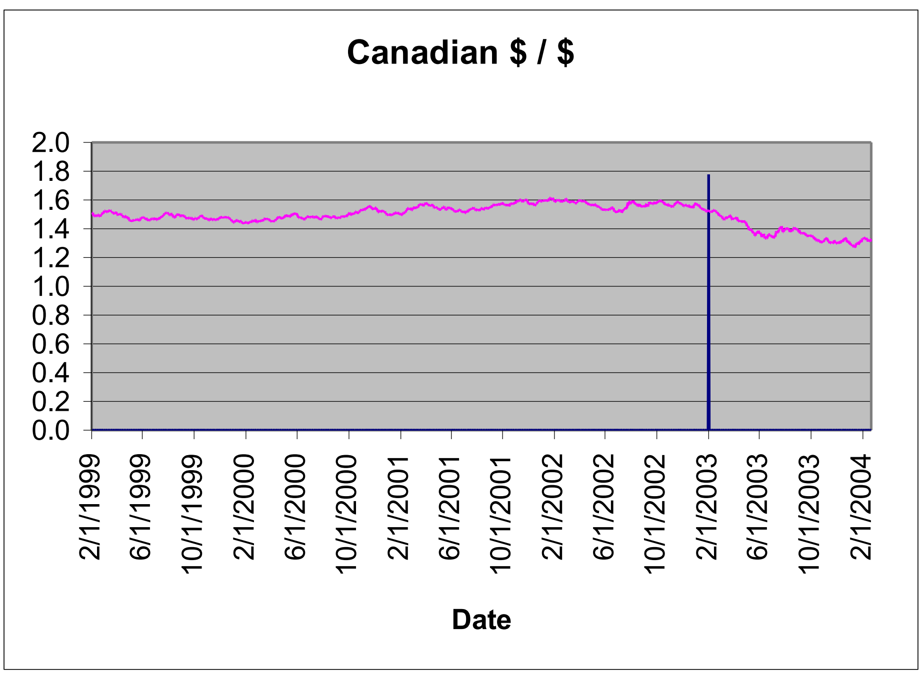
The straight line indicates the end of fiscal year 2003 (January 31st, 2003)

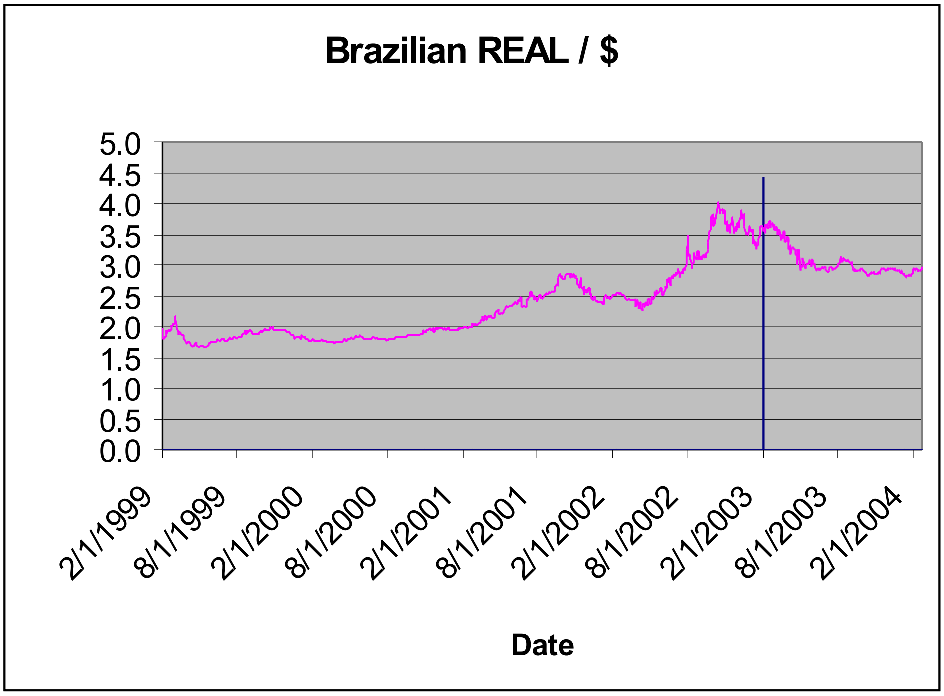




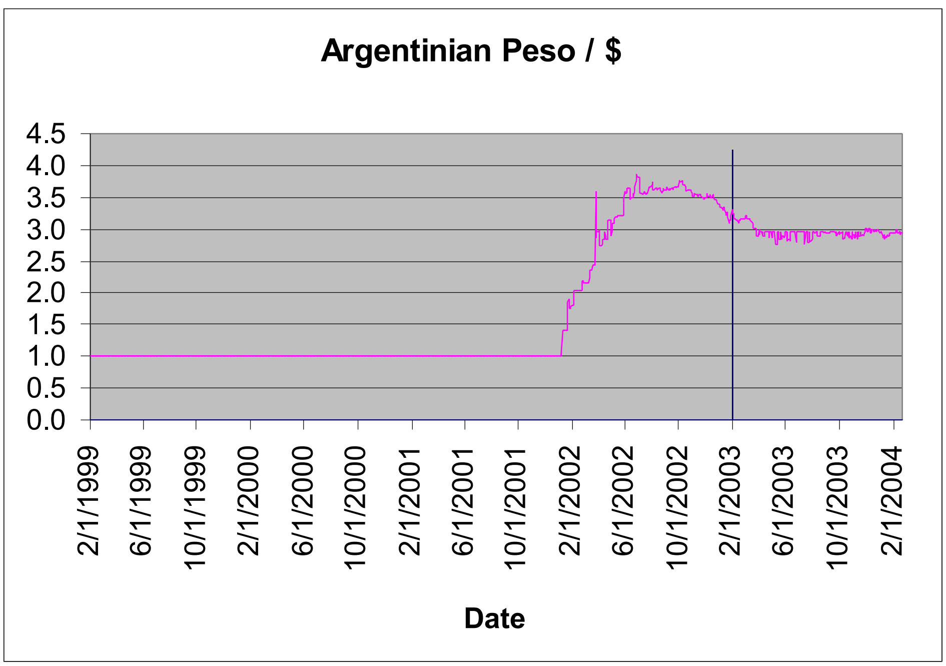
[3] (www.oanda.com currency site)


Chinese YUAN / $
10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
2/1/1999
8/1/1999
2/1/2000
8/1/2000
2/1/2001
8/1/2001
2/1/2002
8/1/2002
2/1/2003
8/1/2003
2/1/2004
Date

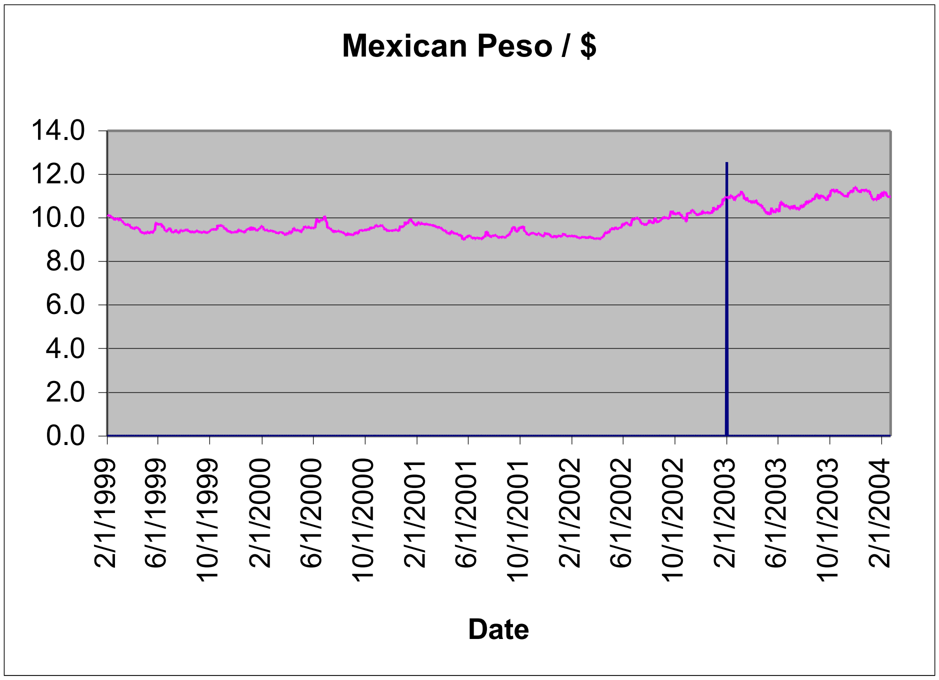

Canadian $ / $
2.0
1.8
1.6
1.4
1.2
1.0
0.8
0.6
0.4
0.2
0.0
2/1/1999
6/1/1999
10/1/1999
2/1/2000
6/1/2000
10/1/2000
2/1/2001
6/1/2001
10/1/2001
2/1/2002
6/1/2002
10/1/2002
2/1/2003
6/1/2003
10/1/2003
2/1/2004
Date

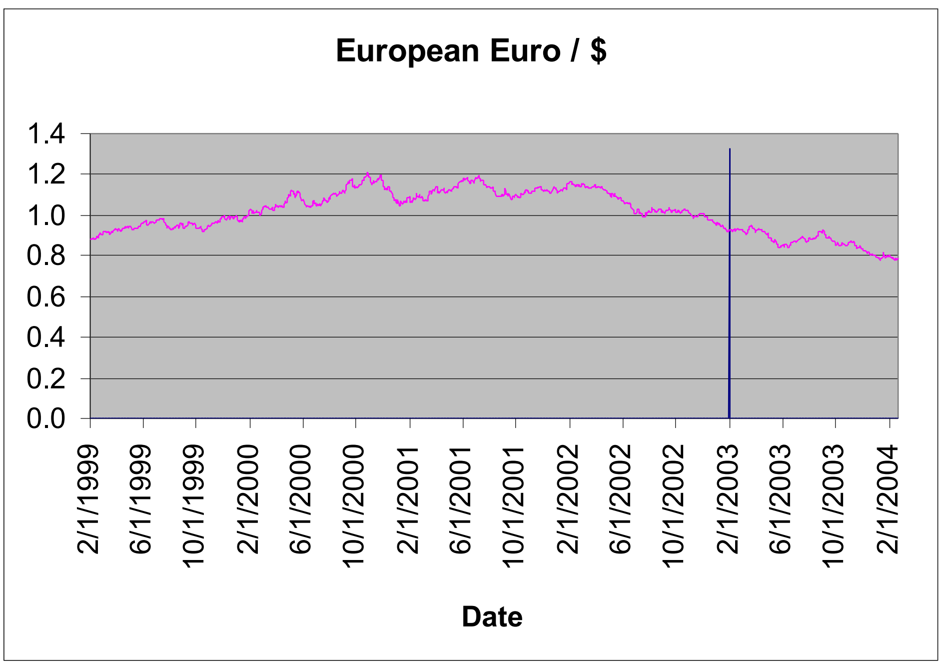


Brazilian REAL / $
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
2/1/1999
8/1/1999
2/1/2000
8/1/2000
2/1/2001
8/1/2001
2/1/2002
8/1/2002
2/1/2003
8/1/2003
2/1/2004
Date



Argentinian Peso / $
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
2/1/1999
6/1/1999
10/1/1999
2/1/2000
6/1/2000
10/1/2000
2/1/2001
6/1/2001
10/1/2001
2/1/2002
6/1/2002
10/1/2002
2/1/2003
6/1/2003
10/1/2003
2/1/2004
Date


Mexican Peso / $
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
2/1/1999
6/1/1999
10/1/1999
2/1/2000
6/1/2000
10/1/2000
2/1/2001
6/1/2001
10/1/2001
2/1/2002
6/1/2002
10/1/2002
2/1/2003
6/1/2003
10/1/2003
2/1/2004
Date


European Euro / $
1.4
1.2
1.0
0.8
0.6
0.4
0.2
0.0
2/1/1999
6/1/1999
10/1/1999
2/1/2000
6/1/2000
10/1/2000
2/1/2001
6/1/2001
10/1/2001
2/1/2002
6/1/2002
10/1/2002
2/1/2003
6/1/2003
10/1/2003
2/1/2004
Date

Appendix 4, Consolidated Balance Sheets

(Amounts in millions) January 31,	2003	2002
Assets		
Current Assets:		
Cash and cash equivalents	**$ 2,758**	$ 2,161
Receivables	**2,108**	2,000
Inventories		
At replacement cost	**25,056**	22,749
Less LIFO reserve	**165**	135
Inventories at LIFO cost	**24,891**	22,614
Prepaid expenses and other	**726**	1,103
Total Current Assets	**30,483**	27,878
Property, Plant and Equipment, at Cost:		
Land	**11,228**	10,241
Building and improvements	**33,750**	28,527
Fixtures and equipment	**15,946**	14,135
Transportation equipment	**1,313**	1,089
	62,237	53,992
Less accumulated depreciation	**13,537**	11,436
Net property, plant and equipment	**48,700**	42,556
Property Under Capital Lease:		
Property under capital lease	**4,814**	4,626
Less accumulated amortization	**1,610**	1,432
Net property under capital leases	**3,204**	3,194
Other Assets and Deferred Charges:		
Goodwill	**9,521**	8,566
Other assets and deferred charges	**2,777**	1,333
Total Assets	**$ 94,685**	$ 83,527
Liabilities and Shareholders' Equity		
Current Liabilities:		
Commercial paper	**$ 1,079**	$ 743
Accounts payable	**17,140**	15,617
Accrued liabilities	**8,945**	7,174
Accrued income taxes	**739**	1,343
Long-term debt due within one year	**4,538**	2,257
Obligations under capital leases due within one year	**176**	148
Total Current Liabilities	**32,617**	27,282
Long-Term Debt	**16,607**	15,687
Long-Term Obligations Under Capital Leases	**3,001**	3,045
Deferred Income Taxes and Other	**1,761**	1,204
Minority Interests	**1,362**	1,207
Shareholders' Equity:		
Preferred stock ($0.10 par value; 100 shares authorized, none issued)		
Common stock ($0.10 par value; 11,000 shares authorized, 4,395 and 4,453 issued and outstanding in 2003 and 2002, respectively)	**440**	445
Capital in excess of par value	**1,482**	1,484
Retained earnings	**37,924**	34,441
Other accumulated comprehensive income	**-509**	-1,268
Total Shareholders' Equity	**39,337**	35,102
Total Liabilities and Shareholders' Equity	**$ 94,685**	$ 83,527

Appendix 4, *Consolidated Statement of Shareholders' Equity*

(Amounts in millions except per share data)	Number of Shares	Common Stock	Capital in Excess of Par Value	Retained Earnings	Other Accumulated Comprehensive Income	Total
Balance – January 31, 2000	4,457	$ 446	$ 714	$ 25,129	($ 455)	$ 25,834
Comprehensive Income						
Net income				6,295		6,295
Other accumulated comprehensive income						
Foreign currency translation adjustment					-1,126	-1,126
Hedge accounting adjustment					897	897
Total Comprehensive Income						**6,066**
Cash dividends ($.24 per share)				-1,070		-1,070
Purchase of Company stock	-4		-8	-185		-193
Issuance of Company stock	11	1	580			581
Stock options exercised and other	6		125			125
Balance – January 31, 2001	4,470	447	1,411	30,169	-684	31,343
Comprehensive Income						
Net income				6,671		6,671
Other accumulated comprehensive income						
Foreign currency translation adjustment					-472	-472
Hedge accounting adjustment					-112	-112
Total Comprehensive Income						**6,087**
Cash dividends ($.28 per share)				-1,249		-1,249
Purchase of Company stock	-24	-2	-62	-1,150		-1,214
Stock options exercised and other	7		135			135
Balance – January 31, 2002	4,453	445	1,484	34,441	-1,268	35,102
Comprehensive Income						
Net income				8,039		8,039
Other accumulated comprehensive income						
Foreign currency translation adjustment					1,113	1,113
Hedge accounting adjustment					-148	-148
Minimum pension liability adjustment					-206	-206
Total Comprehensive Income						**8,798**
Cash dividends ($.30 per share)				-1,328		-1,328
Purchase of Company stock	-63	-5	-150	-3,228		-3,383
Stock options exercised and other	5		148			148
Balance – January 31, 2003	**4,395**	**$ 440**	**$ 1,482**	**$ 37,924**	**($509)**	**$ 39,337**

Appendix 5*, Goodwill as it is recorded on the balance sheet*

	31-Jan-03	31-Jan-02
International	**$ 8,985**	$ 8,028
Sam's Club	**305**	305
Other	**231**	233
Total Goodwill	**$ 9,521**	$ 8,566