**MBA – FIN 534 Term Project: Financial Statements Analysis**

**Industry: Retail – Pharmacies and Drug Stores**

**JU Student**

**GNC Holdings – GNC**

**Herbalife LTD – HLF**

**CVS Health Corporation– CVS**

**Industry Overview**

The Retail – Pharmacies and Drug Stores industry is known for various products and services that benefit society’s wellbeing and overall health not just in the U.S., but throughout the whole world. The Sports Nutrition,Health &Fitness market in the Retail – Pharmacies and Drug Stores industry is one segment thatoffers consumers a large variety of products and choices that are designed to please and satisfy everyone with any and every health goal in mind. From protein powders and pre-workout drinks to creatine and glutamine pills and tablets, there are many products that encompass and make up the $16 billion market in the U.S. economy. It is anticipated that the Sports Nutrition Fitness Market will increase to over $20 billion by year 2020 (Daniells, Stephen, 2015). With numbers like that, it is no surprise that there are new companies entering the market every day; with each company coming up with new concepts and creating new and innovative products, promising amazing results.



(Source: Daniells, Stephen, 2015)

The stigma surrounding this market for years was that it was for bulky, muscle-obsessed, over-sized bodybuilders but over the past few years, there have been new trends emerging that cater to everyone who desires to look and feel great in order to become the best version of his or herself. With the advent of social media sites such as Instagram, Snapchat and Facebook, more and more focus has been placed on not just looking great like an athletebut also performing like one as well. These social media sites are a great way for these Sports Nutrition companies to advertise their products as well as foster collaboration with others around various events such as CrossFit competitions, fitness boot camps, fitness expos and obstacle races. Other things to consider in regards to the Sports Nutrition boom is the emergence of gyms around every corner, which are thriving thanks in part to expansions and franchising that allow for more and more products to be available and sold at multiple locations around every city. These entities are driven by the Sports Nutrition Fitness Market which has its companies sponsor and endorse a lot of the organizations and athletes at these events.Free samples are always provided at these gatherings and offer the companies a prime opportunity to sell their products at these events and in local gyms. The main drivers that sell these products are the national and worldwide chains of stores. These stores are both local – brick and mortar locations as well as online retailers.The three most known are.

The three companies that I have chosen to analyze are GNC Holdings, Herbalife LTD and CVS Health Corporation. Each company is known for offering consumers various products ranging from pre-workout nutrition and intra-workout supplements to post-workout nutrition and weight-management meals but one product in particular stands out for each company when one thinks of health and fitness. This product is sports protein powder which comprises $4.7 billion of the $16 billion market (Daniells, Stephen, 2015).It’s very popular among all pro athletes, bodybuilders and the average gym-goer who just wants to look and feel better. Among these products, these chains also sell beauty products as well as offer educational classes on how to live a better and healthier life.

**GNC Holdings**

GNC (General Nutrition Centers) was started by David Shakarian in 1935 in Pittsburgh, Pennsylvania. Much like TheHerbalife LTD and CVS Health Corporation, GNC offers many types of Sports Nutrition and Health and Fitness products for all consumers. These products include herbs, minerals, vitamins, glutamine, creatine powders and pills, pre-workout supplements, protein powders and health and beauty items just to name a few. When one thinks about buying a product from the world of Sports Nutrition and Health and Fitness, they think of GNC because their stores started opening up across the United States at a very rapid pace in the 1980’s and the growth has continued since then. In the 1980’s there were over 1,000 brick-and-mortar locations but since then, GNC has grown to having over 4,800 locations throughout the United States as well as having franchises that operate in 46 international markets. They are also a large online seller via their website, offering solid products and good discounts. (“COMPANY OVERVIEW.” GNC)

**Herbalife LTD.**

Herbalife has been around since 1980. Their focus is on improving the quality of people’s lives through proper nutritional solutions by way of nutritional items and products as well as educational programs and one-on-one coaching. Their products and services are offered via their distributors. They want to ensure that everyone eats the right way and is living their best life through proper nutrition which will in turn help to eradicate health epidemics such as rising healthcare costs and obesity. Along with products such as protein bars, protein powders and shakes, weight-management recipes and vitamins, Herbalife also provides services such as educational classes, energy and fitness sports drinks as well as natural beauty products that seek to make everyone look and feel at their best. Herbalife is also a big proponent of making sure that children are properly fed in order for them to succeed in life. They also sponsor many high-class athletes throughout the world such as Christian Ronaldo. Herbalife has a net sales of about $4.5 billion in 2016 and they employ over 8,000 people all over the world. (“Herbalife - US - About Herbalife.”)

**CVS Health Corporation**

Consumer Value Stores, better known as CVS began in 1963 in Lowell, Massachusetts. The chain initially started offering beauty and health products but evolved into a chain of stores that now offer full-service pharmacies, educational classes on how to live a better and healthier life and products that will fulfill everyone’s needs from botanicals, vitamins and protein powders and shakes, to energy drinks and healthy-weight management foods, programs, and fitness supplements. CVS is so committed to making people’s lives better and healthier that they enacted a new stop-smoking movement called “Be The First” in 2016. This movement is a $50 million endeavor that strives to give the U.S. the first tobacco-free generation. CVS also acquired over 1,600 Target clinics and pharmacies. In all, there are over 10,000 nationwide CVS stores in the U.S.(“Company History.” CVS Health)

**Competitive Positions**

When it comes to analyzing the competitive positions of each company, there are various factors to consider depending on what is being observed. Some of the most common statistics that insiders and investors observe are based on valuation measures, company financial performance and management effectiveness. One of the key indicators is the Market Capitalization number for each firm which tells the investor what the overall total value is for a firm’s shares of stock (Price of stock multiplied by total quantity of outstanding shares). There are three differently sized market caps to consider which are important because the market cap allows investors to evaluate the worthiness of each company in regards to each company’s value on the open market and the outlook on the acuity of future projections. ("What Is Market Cap? - Fidelity")

As of November 23rd, 2018, GNC Holdings has a Market Cap of $245.78 million, which ranks it as a Small-Cap company. These are usually considered risky because of their sensitivity and predisposition to any potential economic problems since they don’t have the large resources like a Large-Cap company would. Other factors that make them susceptible to economic problems is the hard competition from other firms in their respective industries. Herbalife LTD has a Market Cap of $8.49 billion which ranks it as a Large-Cap companydue to their brand name recognition and large resources. Large-Cap companies are considered a safe and conventional investment. CVS Health Corporation has a Market Cap of $76.59 billion which makes them a Large-Cap company as well. While GNC Holdings isn’t even considered a Mid-Cap company, which is a designated ranking for companies who are at a stage of rising market share and solid growth, GNC Holdings does offer investors the potential of significant growth if they are willing to endure unpredictable price fluctuations in the short term. (www.zacks.com).

A company’s financial performance is also important to investors. One of the main characteristics that sticks out is the Profit Margin. This characteristic shows investors the amount of money that a company makes from every dollar of sales (Profit divided Sales).GNC Holdings comes in with an Operating Margin of 2.40 and a Net Margin of -8.42. Herbalife LTD has an Operating Margin of 8.97 and a Net Margin of 3.84; CVS Health Corporation comes in at an Operating Margin of 3.69 and a Net Margin of 1.65. Herbalife LTD is ahead of the group with CVS coming in second place. GNC Holdings is in last place since it’s the only company out of all three that is generating the smallest Operating Margin and a negative Net Margin after taxes. (www.zacks.com)

Another factor that is considered when it comes to investing is Management Effectiveness. (Dobosz, John). Alongside the Profit Margin, The Return on Assets (ROA = Net Income divided Total Assets) number is also a key measure in regards to producing profit as it shows how effective management is at producing profits from the assets that are invested in the company. The more effective a company’s management is at generating higher profits from each dollar in assets, the higher the ROA will be and thus deem it more attractive to investors. As of 9/30/18, GNC Holdings has an ROA of 3.77; Herbalife LTD has an ROA of 15.61 and CVS Health Corporation has an ROA of 5.61. GNC Holdings has a lower ROA compared to CVS Health Corporation and Herbalife LTD meaning that GNC Holdings will more than likely need to either raise or borrow equity in order to attain higher profits. In regards to the ROA in the Large-Cap company segment, Herbalife LTD is performing better than its peer, CVS Health Corporation,which shows that Herbalife LTD is making better use of their assets than CVS Health Corporation in this analysis. (www.zacks.com)& (Dobosz, John)

**Financial Statements (Numbers presented in $ millions)**

Fiscal Year end for these companies fall in the month of December.





The Income Statements and Balance Sheets above for all three companies are good indicators of the directions that these firms are heading. These financial reports are crucial in an investor’s judgement calls on what companies to invest in. CVS is performing the best out of all three companies in regards to very important metrics. Their Net Income is roughly 30 times larger than that of Herbalife and GNC isn’t even producing a positive net income since their net income has been in the negatives two years in a row. While CVS does have higher liabilities than their competition, GNC and Herbalife, CVS does also have much higher assets. Their assets are 33 time larger than that of Herbalife and 63 times higher than GNC’s. Along with producing superior profits over the competition, CVS is the most attractive to investors based on these metrics.

**Comparative Analysisand Trend Analysis**



**Liquidity Ratios**

**Current** – This ratio is utilized to help an investor measure the short term solvency. Thus, the higher the ratio is, the more attractive the firm will be for the investor. In order to obtain this ratio, you divide current assets/current liabilities. GNC has the highest Current Ratio in comparison to the other firms.

**Quick** – The Quick Ratio (acid test ratio) helps an investor measure a company’s capacity and capability to pay off short-term obligations without depending upon the sale of inventories. In order to obtain this ratio, take the (current assets-inventories)/current liabilities. GNC and CVS have quick ratios below 1.0 and thus they would need to be liquidated in order to pay off current liabilities if that time comes and if it is necessary during that period.

**Asset Management Ratio**

**Total Assets Turnover** – This ratio measures the dollars in sales that are generated for each dollar that is tied up in assets. In order to obtain this ratio, divide sales/total assets. All three companies are around the same level but Herbalife is slightly below the others in regards to not generating as much business in comparison to the others in regards to its total asset investment.

**Fixed Assets Turnover** – This ratio measures how effectively the firm uses its plant and equipment. In order to obtain this ratio, it’s Sales/Net Fixed Assets. Once again Herbalife is below GNC and CVS in regards to this ratio which indicates that they are not using its fixed assets as intensively as their competition in this analysis. With Herbalife being such a big proponent of distribution centers being at the helm of selling their products and services, they may need to reevaluate their operations at each DC in order to improve efficiency.

**Days Sales Outstanding (DSO)** – This ratio is also called the Average Collection Period (ACP) and it is used to appraise accounts receivable and it’s calculated by dividing accounts receivable by average daily sales to find the number of days’ sales that are tied up in receivables. CVS has the highest days outstanding which is not good as this means that customers aren’t paying on time. This affects the stock price.

**Inventory Turnover** – This ratio is defined as the cost of goods sold divided by the inventories. Herbalife has the lowest number in regards to this ratio, which is not good as this indicates that they are holding too much inventory, which is not just limited to obsolete products that are taking up space. This diminishes the stock price.

**Debt Management Ratio**

**Debt-to-Assets Ratio** – This ratio is the ratio of total debt to total assets (Total Debt/Total Assets). GNC has a significantly higher Debt-to-Assets Ratio than their counterparts which looks like is one of the many factors holding them back from expanding like CVS and Herbalife.

**Times-Interest-Earned (TIE)** – This ratio is also called the Interest Coverage Ratio, which is determined by dividing the earnings before interest and taxes (EBIT) by the interest expense. This ratio helps investors measure the extent to which operating income can decline before the firm is unable to meet its annual interest costs. Herbalife has the highest TIE, which means that they would not have any issues paying interest and should they need additional funds, they would not have a problem receiving funds.

**Profitability Ratio**

**Profit Margin on Sales** – This ratio is obtained by dividing the net income by sales. It shows investors the profit per dollar of sales. Herbalife has the best Profit Margin on Sales which means they are operating efficiently where as GNC is in the negatives, thus indicating that there are a host of problems that need to be addressed by the company, not just inefficient operations or high interest expenses.

**Basic Earning Power (BEP)** – This ratio is obtained by dividing earnings before interest and taxes (EBIT) by total assets. It shows investors the earning power of the firm’s assets before the influence of taxes and leverage and it is useful for comparing forms with different tax situations and different degrees of financial leverage. GNC surprisingly has a higher BEP than CVS but Herbalife has both of them beat. CVS has the lowest BEP and thusindicating that they are not getting a high a return on their assets.

**Return on Total Assets (ROA)**–This ratio shows investors the net income to total assets after interest and taxes. Herbalife and CVS have healthy ROAs but GNC’s were in the negatives for 2017 and 2016 but have improved a lot in 2018.

**Return on Common Equity (ROE)** – This ratio of net income to common equity allows investors to see how well their money is earning a return. GNC ranks the highest amongst all three companies in regardsto this aspect.

**Market Value Ratio**

**Price/Earnings (P/E)** – This ratio shows investors how much they are willing to pay per dollar of reported profits. The P/E will be higher for companies with solid growth potential and lower for riskier companies. Investors are fine with paying a larger percentage for all three firms. CVS has the highest P/E and GNC is surprisingly in second place, thus leaving Herbalife in last place in regards to this category.

**Market/Book (M/B)** – This ratio is obtained by dividing the market price per share by the book value per share. GNC is doing well in regards to this aspect and investors are not shying away from this company.

Definitions Source – (Brigham, Eugene F, and Michael C Ehrhardt. Financial Management, 2016).

**Recommended Changes**

Out of all three companies in this analysis, CVS is doing the best overall. They have the best Debt-to-Asset Ratio and consistent numbers in regards to their return on total assets and profit margin on sales. They could definitely improve upon their DSO by enforcing tighter payment plan requirements so thatthey do not have that many days of sales outstanding. This improvement would boost their stock price as well. Herbalife is doing well as they are producing a solid profit margin on sales year-over-year and have a positive net income. However, they need to improve upon their inventory turnover as this area lacks efficiency and thus they are losing money at underperforming distribution centers across the nation. However, their DSO is the lowest out of all three companies in this comparison, which shows us that they are collecting on outstanding funds on their products being sold to customers. GNC needs a lot of improvement. They have generated a negative net income on back-to-back years (2016 and 2017) and they have a negative profit margin on sales. They may need to look at their excessive amount of brick-and-mortar locations and potentially close some stores and focus more on their online sales. This would reduce debt-to-asset ratio, thus improve their net income, and boost their stock price. Another thing to focus on for GNC is their inventory turnover, which could use a big improvement. Their brick-and-mortar locations are holding onto a lot of obsolete products which need to be sold rapidly. Their DSO is also fairly high and needs to be reduced in order to boost stock prices.

**Appendix A**





**Appendix B**





**Appendix C**





**Citations**

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