Wal-Mart Stores (WMT)

Updated July 2nd, 2018 by Josh Arnold

Key Metrics

Current Price:	$86	**5 Year CAGR Estimate:**	4.9%	**Volatility Percentile:**	32.2%
Fair Value Price:	$70	**5 Year Growth Estimate:**	5.5%	**Momentum Percentile:**	59.4%
% Fair Value:	117%	**5 Year Valuation Multiple Estimate:**	-3.0%	**Valuation Percentile:**	24.8%
Dividend Yield:	2.4%	**5 Year Price Target**	$96	**Total Return Percentile:**	20.4%

Overview & Current Events

Wal-Mart Stores traces its roots back to 1945 when Sam Walton opened his first discount store. The company has since grown into the largest retailer in the world, serving 270 million customers each week. Revenue is expected to top $500 billion this year and WMT's market cap is $253 billion.

Wal-Mart's recent first quarter report wasn't well received by investors as the company missed on earnings-per-share by four cents. Traffic rose 1.6%, leading to a 2.6% total comparable sales increase, but the company has already begun spending projected savings from tax reform, leading to increased costs that crimped margins. WMT continues to invest heavily in its successful omnichannel strategy to fuel future growth but those costs caught up with the company in Q1. WMT has also invested $16B in Flipkart, India's largest online retailer of consumer goods, as another avenue for growth.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$3.42	$3.66	$4.07	$4.55	$5.02	$5.11	$5.07	$4.57	$4.32	$4.42	***$4.90***	***$6.40***
DPS	$0.95	$1.09	$1.21	$1.46	$1.59	$1.88	$1.92	$1.96	$2.00	$2.04	***$2.08***	***$2.40***

EPS growth has been steady considering the varied economic environments we've seen in the past decade but of late, that growth has tailed off. The biggest concern is operating margins as gross margins have remained flat while operating expenses have risen. This is the product of WMT's focus on building out its online business as well as integrating its acquisitions, both of which are expensive endeavors, as evidenced by Q1's earnings miss.

Looking forward, we are forecasting 5.5% annual EPS growth for the next five years as WMT continues to work through its margin issues. The company continues to buy back stock as well as we see low single digit sales growth each year, with its e-commerce business being the primary driver of top line growth. That combination should be good enough to create mid-single digit EPS growth without the benefit of margin expansion. Upside could be seen from higher margins but given WMT's strategic direction as well as recent history as a guide, we aren't forecasting margin growth at this point.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	16.2	13.9	13.1	12.4	13.5	14.9	15.4	15.5	16.2	18.9	***17.5***	***15.0***
Avg. Yld.	1.7%	2.1%	2.3%	2.7%	2.3%	2.5%	2.5%	2.8%	2.9%	2.1%	***2.4%***	***2.5%***

WMT's valuation hasn't moved around much in the past decade but last year did mark the high point in the stock's multiple. A steady rise to a price-to-earnings ratio of almost 19 was a sizable move from its trough of 12.4 back in 2011, as investors bet heavily on the future of the e-commerce business. That enthusiasm has since waned and WMT is back to 17.5 for now, but we are forecasting a continued drift lower to a PE of 15, which is more in line with its historical valuations. As such, we believe WMT is trading in excess of fair value right now and will see a 3.0% annual headwind on a total return basis as a result of the continued revaluation of the stock.

The dividend yield fell off in 2017 as a result of the meteoric rise in the stock price but has since recovered to 2.4%. We are forecasting low single digit growth in the dividend going forward as WMT's strategy has shifted towards spending excess cash on growth, not dividends. Thus, the yield should be roughly flat from today's levels moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	22.7%	24.6%	24.6%	23.9%	23.8%	24.4%	24.3%	25.0%	24.9%	24.9%	***24.9%***	***25.0%***
Debt/A	60%	60%	59%	62%	63%	62%	63%	60%	60%	61%	***64%***	***64%***
Int. Cov.	12.4	12.1	12.8	12.8	12.3	13.5	12.2	11.6	9.8	10.1	***8.0***	***9.0***
Payout	28%	28%	30%	30%	33%	32%	37%	38%	43%	46%	***42%***	***38%***
Std. Dev.	33.8%	21.1%	14.0%	16.8%	16.6%	12.4%	13.5%	20.6%	18.9%	18.4%	***17.0%***	***18.6%***

WMT's debt coverage metrics have been steady in the past decade, neither improving nor deteriorating. This is due to its ample free cash flow as well as its willingness to do small, digestible acquisitions. However, WMT is looking to finance its $16B Flipkart investment with debt and as a result, we have increased our expectation for its debt-to-asset ratio and decreased forecast interest coverage. However, WMT has plenty of room on both of these metrics for additional debt, so it is not a concern at this point.

WMT's competitive advantage is in its enormous size as it can buy and ship product at scales no other company on earth can rival. This allows it to operate with low prices to consumers and as more than half of its revenue comes from groceries, its recession performance is excellent. WMT makes its living off of staples and necessities that people buy irrespective of economic conditions; the company managed to increase earnings steadily during and after the Great Recession. Hard economic conditions tend to send consumers on the margins to WMT, which is an advantage as well.

Final Thoughts & Recommendation

Overall, WMT looks overvalued here as it trades at a significant premium to its fair value. The company's growth hasn't kept pace with stock price gains in recent years and that has led to its price-to-earnings ratio starting to come back down to historical levels. We are forecasting total five-year annual returns of 4.9% comprised of the 2.4% current yield, 5.5% EPS growth and a 3.0% headwind from the valuation that we think will continue to come down.

WMT is a safe, defensive stock in times of economic hardship but growth is going to be limited as it works through its margin issues and stock price that is in excess of fair value. For those seeking growth, a strong current yield or dividend growth, WMT does not fit the bill; it works only for those investors that are seeking a defensive mega-cap stock.

Total Return Breakdown by Year