Wal-Mart Stores (WMT)

Updated April 7th, 2018 by Josh Arnold

Key Metrics

Current Price:	$83	**5 Year CAGR Estimate:**	4.6%	**Quality Percentile:**	N/A
Fair Value Price:	$70	**5 Year Growth Estimate:**	5.5%	**Momentum Percentile:**	N/A
% Fair Value:	118%	**5 Year Valuation Multiple Estimate:**	-3.3%	**Total Return Percentile:**	N/A
Dividend Yield:	2.4%	**5 Year Price Target**	$96	**Valuation Percentile:**	N/A

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 $255 billion.

The company's recent Q4 report was mixed as sales growth continued but margin were pressured. Revenue was up 4.1% as comparable store sales rose 2.6% on strength in the e-commerce business, helped along by a 1% tailwind from forex translation. However, operating income fell 28% as gross margins continue to see pressure and expenses keep rising. WMT has been more focused on growth than margins in recent years, evidenced by its Jet acquisition in late 2016 as well as its current interest in Flipkart, and rumors surrounding PillPack and even Humana. WMT's strategic shift will bring the next leg of revenue growth but margins are certainly an item worthy of attention after years of weakness.

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.

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 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 we 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	***17.7***	***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 PE 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 17.7 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 3.3% 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%	***61%***	***60%***
Int. Cov.	12.4	12.1	12.8	12.8	12.3	13.5	12.2	11.6	9.8	10.1	***9.0***	***10.0***
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. These metrics should be steady unless WMT ends up completing an acquisition the size of Humana or Flipkart, which could meaningfully deteriorate its debt-to-asset ratio and/or its interest coverage. Unless that happens, however, these metrics should remain roughly flat.

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 EPS 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 PE starting to come back down to historical levels. We are forecasting total five-year annual returns of 4.6% comprised of the 2.4% current yield, 5.5% EPS growth and a 3.3% headwind from the valuation.

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