Wal-Mart Stores (WMT)

Updated August 18th, 2018 by Josh Arnold

Key Metrics

Current Price:	$98	**5 Year CAGR Estimate:**	2.4%	**Volatility Percentile:**	29.8%
Fair Value Price:	$75	**5 Year Growth Estimate:**	5.5%	**Momentum Percentile:**	70.4%
% Fair Value:	130%	**5 Year Valuation Multiple Estimate:**	-5.2%	**Valuation Percentile:**	16.4%
Dividend Yield:	2.1%	**5 Year Price Target**	$98	**Total Return Percentile:**	11.9%

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 will top $500 billion this year and the stock's market capitalization is $289 billion.

Wal-Mart reported Q2 earnings on 8/16/18 and results were better than expectations at $1.29 in earnings-per-share. Total revenue rose more than 4% as US comparable sales rose 4.5%. The gain came from roughly congruent parts of traffic and average ticket boosts, driven by strength in grocery and apparel sales. Sam's Club also produced a surprise 5% comp sales gain, while the e-commerce and international businesses both exhibited strength as well. Management boosted guidance slightly and we've raised our estimate for this year in sympathy, although the gain was slight. Still, Wal-Mart's Q2 report was outstanding and we think it improves the company's near-term outlook meaningfully.

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	***$5.00***	***$6.55***
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***

Earnings-per-share 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, something we saw in the Q2 report once again. This is the product of Wal-Mart's focus on building out its online business as well as integrating its acquisitions, both of which are expensive endeavors. Indeed, despite strong sales, Q2's operating income was slightly lower than last year's Q2.

Looking forward, we are forecasting 5.5% annual earnings growth for the next five years as Wal-Mart 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 growth without the benefit of margin expansion. Upside could be seen from higher margins but given Wal-Mart's strategic direction, we are not 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	***19.6***	***15.0***
Avg. Yld.	1.7%	2.1%	2.3%	2.7%	2.3%	2.5%	2.5%	2.8%	2.9%	2.1%	***2.1%***	***2.5%***

Wal-Mart's valuation has not moved around much in the past decade the stock is currently at its highest valuation in the past decade. Investors continue to bet heavily on the future of the e-commerce business, but it has made the stock expensive on a historical basis. We are forecasting the price-to-earnings multiple to fall to 15, which is more in line with its historical valuations. As such, we believe Wal-Mart is trading well in excess of fair value right now and will see a 5.2% annual headwind on a total return basis as a result of the revaluation of the stock. The yield is back down to 2.1% thanks to the higher valuation, at the lower end of its historical range. We are forecasting low single digit growth in the dividend going forward as Wal-Mart's strategy has shifted towards spending excess cash on growth, not dividends.

However, given the low current yield, we expect it to rise in the coming years back towards the mid-2% range, commensurate with its historical norms.

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%***	***37%***
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%***

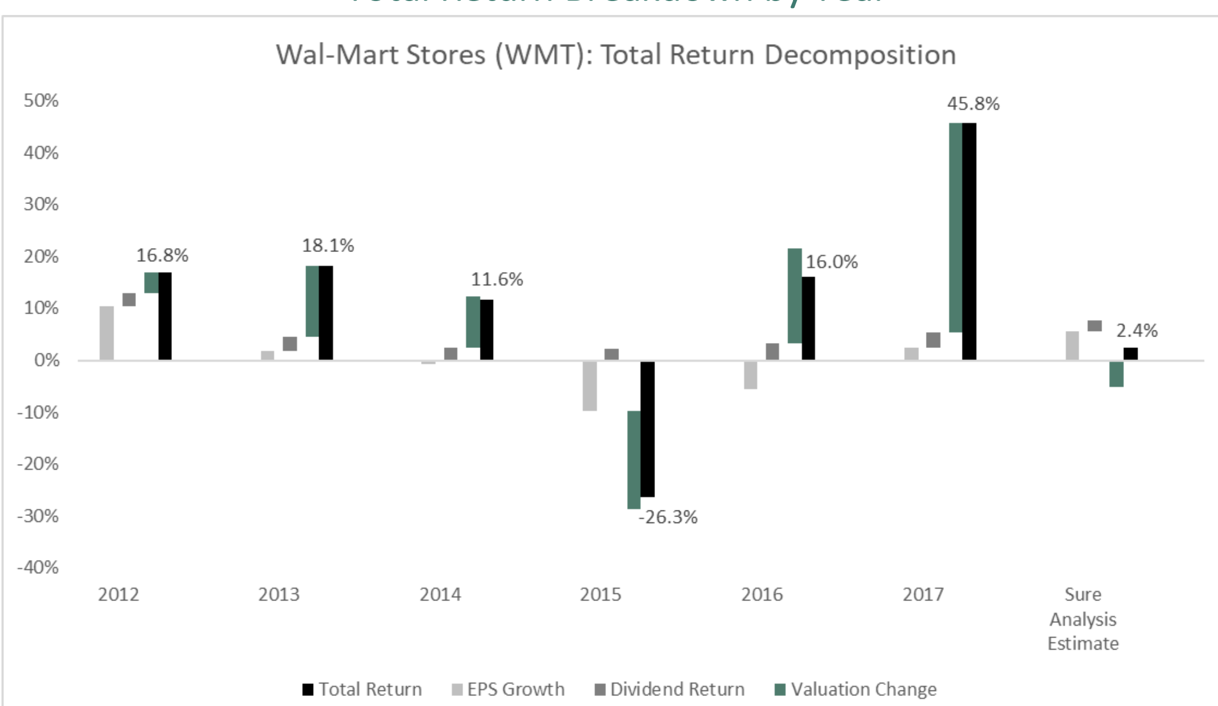
Wal-Mart's debt coverage metrics have been steady in the past decade, neither improving nor deteriorating. This is due to its ample free cash flow as well as its willingness to do small, digestible acquisitions. However, Wal-Mart financed its $16 billion Flipkart investment with debt and as a result,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

Wal-Mart'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. Wal-Mart makes its living from 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 Wal-Mart, which is also an advantage.

Final Thoughts & Recommendation

Overall, Wal-Mart looks overvalued here as it trades at a significant premium to its fair value. The company's growth has not kept pace with stock price gains in recent years and that has led to a rising price-to-earnings ratio. We are forecasting total five-year annual returns of just 2.4%, comprised of the 2.1% current yield, 5.5% earnings growth and a 5.2% headwind from the valuation that we think will continue to come down. Wal-Mart 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. Given low projected total returns, the stock earns a sell recommendation at current prices.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.