



# Wal-Mart Stores (WMT)

Updated November 20<sup>th</sup>, 2018 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$96	<b>5 Year CAGR Estimate:</b>	2.1%	<b>Volatility Percentile:</b>	22.9%
<b>Fair Value Price:</b>	\$72	<b>5 Year Growth Estimate:</b>	5.5%	<b>Momentum Percentile:</b>	48.3%
<b>% Fair Value:</b>	133%	<b>5 Year Valuation Multiple Estimate:</b>	-5.6%	<b>Growth Percentile:</b>	45.6%
<b>Dividend Yield:</b>	2.2%	<b>5 Year Price Target</b>	\$94	<b>Valuation Percentile:</b>	12.5%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Total Return Percentile:</b>	9.0%

## 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 trades with a market capitalization of \$283 billion.

Wal-Mart reported Q3 earnings on 11/15/18 and results were strong once again. Total revenue increased 1.4% but excluding the impact of currency fluctuations, it was up 2.4%. Wal-Mart's international presence continues to negatively impact consolidated results due to a relatively strong US dollar. In the US, Wal-Mart continues to show enormous strength as its comparable sales rose 3.4%, creating a two-year stack comparable sales number of 6.1%. Traffic was up 1.2% while average ticket size rose 2.2% during the quarter. The ecommerce business showed a 43% gain year-over-year as Wal-Mart's multi-billion dollar investment in modernizing its supply chain continues to bear fruit. Wal-Mart cited industry groups that said it gained market share in key categories and that market share continues to drive very strong comparable sales results quarter after quarter. Grocery pickup, a key strategic initiative for Wal-Mart, is now available at 2,100 locations and the company's grocery delivery service is available at 600 locations, with more to come.

Sam's Club, which has acted as an anchor for Wal-Mart in recent years, showed some signs of life as it gained 3.2% in comparable sales, helped along by a 32% ecommerce gain. In addition, Wal-Mart noted that Sam's Club membership trends continue to improve, showing some optimism with respect to the once-struggling chain.

In total, operating income rose slightly year-over-year while guidance for Q4 was below consensus. As a result, we've lowered our earnings-per-share estimate for this year to \$4.80, which is at the midpoint of the new adjusted earnings-per-share guidance range management provided of \$4.75 to \$4.85.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$3.42	\$3.66	\$4.07	\$4.55	\$5.02	\$5.11	\$5.07	\$4.57	\$4.32	\$4.42	<b>\$4.80</b>	<b>\$6.27</b>
<b>DPS</b>	\$0.95	\$1.09	\$1.21	\$1.46	\$1.59	\$1.88	\$1.92	\$1.96	\$2.00	\$2.04	<b>\$2.08</b>	<b>\$2.40</b>
<b>Shares</b>	3,925	3,786	3,516	3,418	3,314	3,233	3,228	3,162	3,048	2,952	<b>2,930</b>	<b>2,650</b>

The largest concern for Wal-Mart is operating margins as gross margins have remained flat while operating expenses have risen, something we've seen for a few quarters now. 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. While Q3 operating income was higher year-over-year, sales gains continue to outpace profitability gains because of this.

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. We continue to be bullish on Wal-Mart's ability to grow revenue, but its margins are suffering as a result. Presumably, margins will bottom out and perhaps we are seeing the first signs of that, but for now, our base case is flat or slightly lower margins.

*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.*



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## 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%	2.2%	2.6%

Wal-Mart's valuation is currently at its highest level of the past decade. Investors continue to bet heavily on the future of the e-commerce business, but it has made the stock expensive. We are forecasting the price-to-earnings multiple to fall to 15, creating a 5.6% annual headwind on a total return basis as a result of the revaluation of the stock. The yield is back down to 2.2% thanks to the higher valuation, at the lower end of its historical range. 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
Payout	28%	28%	30%	30%	33%	32%	37%	38%	43%	46%	43%	38%

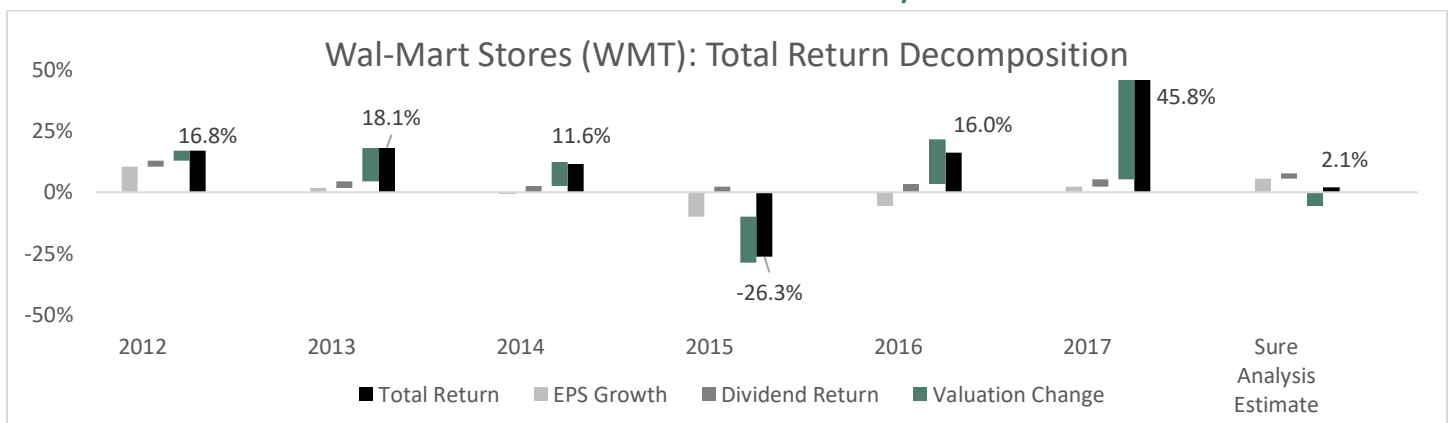
Wal-Mart's debt coverage metrics have been steady in the past decade, neither improving nor deteriorating. This is due to its ample free cash flow as well as its willingness to do small, digestible acquisitions. However, Wal-Mart financed its \$16 billion Flipkart investment with debt and as a result, 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 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. 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 continues to trade 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 2.1%, comprised of the 2.2% current yield, 5.5% earnings growth and a 5.6% 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



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue (\$B)</b>	404.37	408.09	421.85	446.51	468.65	476.29	485.65	482.13	485.87	500.34
<b>Gross Profit (\$B)</b>	100.32	103.98	106.90	111.52	116.35	118.23	120.57	121.15	124.62	126.95
<b>Gross Margin</b>	24.8%	25.5%	25.3%	25.0%	24.8%	24.8%	24.8%	25.1%	25.6%	25.4%
<b>SG&amp;A Exp. (\$B)</b>	77.52	79.98	81.36	85.03	88.63	91.35	93.42	97.04	101.85	106.51
<b>D&amp;A Exp.</b>	6739	7157	7641	8106	8478	8870	9173	9454	10080	10529
<b>Operating Profit</b>	22798	24002	25542	26491	27725	26872	27147	24105	22764	20437
<b>Op. Margin</b>	5.6%	5.9%	6.1%	5.9%	5.9%	5.6%	5.6%	5.0%	4.7%	4.1%
<b>Net Profit</b>	13400	14370	16389	15699	16999	16022	16363	14694	13643	9862
<b>Net Margin</b>	3.3%	3.5%	3.9%	3.5%	3.6%	3.4%	3.4%	3.0%	2.8%	2.0%
<b>Free Cash Flow</b>	11648	14065	10944	10745	12693	10142	16390	16075	21054	18286
<b>Income Tax</b>	7145	7156	7579	7924	7958	8105	7985	6558	6204	4600

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets (\$B)</b>	163.43	170.41	180.78	193.41	203.11	204.75	203.49	199.58	198.83	204.52
<b>Cash &amp; Equivalents</b>	7275	7907	7395	6550	7781	7281	9135	8705	6867	6756
<b>Acc. Receivable</b>	N/A	N/A	5089	5937	6768	6677	6778	5624	5835	5614
<b>Inventories</b>	34511	32713	36437	40714	43803	44858	45141	44469	43046	43783
<b>Goodwill &amp; Int.</b>	15260	16126	16763	20651	20497	19510	18102	16695	17037	18242
<b>Total Liab. (\$B)</b>	96.35	97.45	109.54	117.65	121.37	123.41	117.55	115.97	118.29	123.70
<b>Accounts Payable</b>	28849	30451	33676	36608	38080	37415	38410	38487	41433	46092
<b>Long-Term Debt</b>	38703	37804	46378	50092	50786	53544	47272	43667	39370	39040
<b>Total Equity</b>	65285	70468	68542	71315	76343	76255	81394	80546	77798	77869
<b>D/E Ratio</b>	0.59	0.54	0.68	0.70	0.67	0.70	0.58	0.54	0.51	0.50

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	8.2%	8.6%	9.3%	8.4%	8.6%	7.9%	8.0%	7.3%	6.8%	4.9%
<b>Return on Equity</b>	20.6%	21.2%	23.6%	22.5%	23.0%	21.0%	20.8%	18.1%	17.2%	12.7%
<b>ROIC</b>	12.6%	13.3%	14.4%	12.9%	13.2%	12.0%	12.2%	11.3%	11.0%	8.2%
<b>Shares Out.</b>	3,925	3,786	3,516	3,418	3,314	3,233	3,228	3,162	3,048	2,952
<b>Revenue/Share</b>	102.35	105.26	114.95	128.53	138.29	145.08	149.75	149.87	156.13	166.23
<b>FCF/Share</b>	2.95	3.63	2.98	3.09	3.75	3.09	5.05	5.00	6.77	6.08

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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