

St. John's University Undergraduate
Student Managed Investment Fund
Presents:

Wal-Mart Stores, Inc.
Stock Analysis



Recommendation: Do Not Buy

Industry: Consumer Staples

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Share Data:

Price (Dec. 5, 2008): \$58.21
Shares Outstanding: 3.922 B
Market Capitalization: \$228 B
52-Week High: \$63.85
52-Week Low: \$43.1

Fundamentals:

P/E (Dec. 2, 2008): 15.508
Diluted EPS 2008 (YTD): \$2.38
Diluted EPS 2009 (EST): \$3.66
Dividend (2008): \$0.95
Dividend Yield: 1.63%



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I. Executive Summary

Based on our analysis of Wal-Mart's financials, its industry, future outlook, and current news, we feel that Wal-Mart's stock is fairly valued. We reached our decision based on the following information:

1. As of December 5, 2008 the closing price on Wal-Mart's stock was \$58.21
2. Our Relative Evaluation suggests that Wal-Mart is fairly priced.
3. Our Absolute Evaluation shows that the market is currently pricing in an eventual slowdown in Wal-Mart's growth as a result of the saturation in the U.S. market and difficulty penetrating international markets.
 - a. Wal-Mart is currently more focused on converting its Discount Stores into Supercenters, rather than building new stores.
 - b. Wal-Mart was forced to sell its stores in South Korea and Germany.
4. Gross Margin and Net Profit Margin have been flat over the last five years while Return on Equity has decreased over the same period.
5. Wal-Mart has announced that it will temporarily suspended its stock repurchase program, which could negatively affect future EPS

II. Company Overview¹

Sam Walton opened the first Wal-Mart store in 1962 in Rogers, Arkansas. Over its 46 year history, Wal-Mart has grown to become the world's largest retailer. Wal-Mart is now currently bigger than Europe's Carrefour, Tesco, and Metro AG combined. Over 176 million customers visit one of Wal-Mart's stores worldwide each week. In the United States, Wal-Mart consists of more than 4,100 stores, including 971 discount stores, 2,447 supercenters, 591 wholesale stores (Sam's Club), and 132 neighborhood markets. In addition, Wal-Mart has 3,121 international stores as of January 31, 2008. About 75% of its revenue comes from its United States' operations, but Wal-Mart does have an expanding international presence. Currently, Wal-Mart is the #1 retailer in Canada and Mexico. As part of its international operations, Wal-Mart owns a 95% stake in Japanese retailer SEIYU and has operations in Asia, Europe, and South America.

Wal-Mart Discount Stores

The first store opened by Sam Walton was a Wal-Mart Discount Store. There are currently 971 discount stores in the United States with an average size of 107,000 square feet and average employment of 225 associates. Wal-Mart Discount Stores feature electronics, jewelry, toys, hardware, furniture, pet supplies, and family apparel.

Wal-Mart Supercenters

The first Wal-Mart Supercenter was opened in 1988 in order to meet the growing demand for a one-stop shopping experience. These supercenters save consumers time and money by offering customers a larger array of products and groceries at the same low prices, which has been Wal-Mart's trademark. In addition, most supercenters have specialty shops including vision centers, health clinics, pharmacies, fast food restaurants, banks, and hair salons. There are 2,447 Wal-Mart Supercenters in the United States (most of which are open 24 hours) with an average size of 187,000 square feet and more than 350 associates. Wal-Mart is currently in the process of converting as many Discount Stores into Supercenters as possible.

Wal-Mart Neighborhood Markets

First opened in 1998, Wal-Mart Neighborhood Markets offer customers a quick and convenient shopping experience for those in need of groceries, pharmaceuticals and other general goods. A typical Neighborhood Market has about 42,000 square feet and includes a deli, bakery, drive-through pharmacy, and goods typically found in a grocery store. There are currently 132 of these stores, each of which employs an average of 95 associates. These stores are usually located in the same markets as Wal-Mart Supercenters. This enables Wal-Mart to use its strong distribution network while enticing customers with easier parking and quicker check-out.

¹ Wal-Mart's Annual Report and Investor Relations Website

Sam's Club

The first Sam's Club was opened in 1983 in Midwest City, Oklahoma. Currently, Wal-Mart operates 591 Sam's Clubs in the United States and more than 100 in Brazil, Canada, China, Mexico, and Puerto Rico. An average Sam's Club warehouse store consists of approximately 132,000 square feet and 175 associates. For a small annual fee of \$35 for small businesses and \$40 for individuals, customers are able to buy goods at wholesale prices.

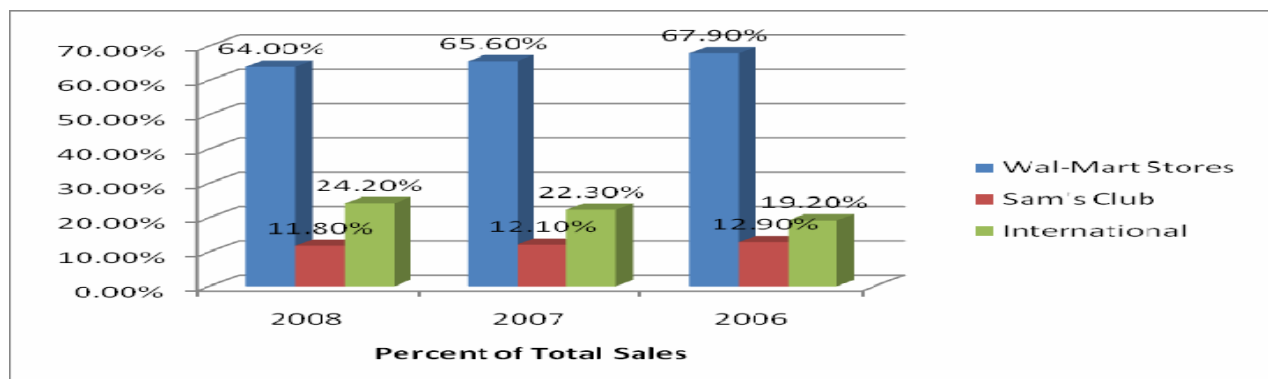
International Stores

Wal-Mart became an international company in 1991 when it opened a Sam's Club near Mexico City. Currently, Wal-Mart serves more than 49 million international customers a week and employs more than 620,000 associates in 3,121 stores in 13 markets, including Canada, Mexico, United Kingdom, Brazil, Puerto Rico, Japan, China, El Salvador, Argentina, Honduras, Costa Rica, Guatemala, and Nicaragua.

Breakdown of Revenue

Wal-Mart breaks its revenue into three segments: Wal-Mart Stores in the U.S., Sam's Clubs in the U.S., and International Stores. Although net sales in Wal-Mart Stores in the United States have increased each year, their contribution to Wal-Mart's total sales has decreased in the last three years due to a significant increase in international sales. As of 2008, Wal-Mart Stores in the United States generated net sales of over \$239 billion, which made up 64% of Wal-Mart's sales. International sales have grown from nearly \$60 billion in 2006 (19.2% of total sales) to over \$90 billion in 2008 (24.2% of total sales), primarily as a result of the currency exchange and the weak U.S. dollar. Sales at Sam's Club, the smallest segment of Wal-Mart's total sales, have remained relatively flat the last few years, with sales in 2008 being approximately \$44 billion and accounting for nearly 12% of total sales.

	2008		2007		2006	
	Net Sales	Percent of Total	Net Sales	Percent of Total	Net Sales	Percent of Total
Wal-Mart Stores	\$239,529	64.00%	\$226,294	65.60%	\$209,910	67.90%
Sam's Club	\$44,357	11.80%	\$41,582	12.10%	\$39,798	12.90%
International	\$90,640	24.20%	\$71,116	22.30%	\$59,237	19.20%



Recent News

November Sales²

November sales at Wal-Mart Stores in the United States open at least one year, including Sam's Club, rose 3.4%, according to Thomson Reuters. Total U.S. sales for the four weeks ended Nov. 28 rose 6.5% from a year earlier to \$21.48 billion, while total company sales, including those overseas, rose 1.6%. International sales decreased by 11% due to sharp increase in the U.S. dollar.

Toy Recalls³

The U.S. Consumer Product Safety Commission's report states that two-thirds of the 43 million products recalled were children's toys, nursery items, and clothing. Of all the products recalled, 97% were internationally made, with 81% of the products made in Chinese factories. Wal-Mart has stepped up its safety standards by putting more pressure on their suppliers.

Wal-Mart's New CEO⁴

Wal-Mart has announced that Vice-Chairman and head of Wal-Mart International Mike Duke will succeed Lee Scott as President and CEO, effective February 1, 2009. This announcement shows how important the expansion of Wal-Mart International is to the company's future.

Wal-Mart to Buy Wind Power⁵

Wal-Mart will buy wind power from Duke Energy to supply up to 15% of the company's total energy load for its 360 Texas stores and facilities. It is expected that Duke Energy will begin producing electricity for Wal-Mart by April of 2009.

Wal-Mart Suspends Stock Repurchase Program⁶

Wal-Mart announced on December 9, 2009 that it will stop repurchasing common stock temporarily because of the economic environment and the instability of the credit market.

² Kitchen, Michael. "Wal-Mart's Total U.S. Same-Store Sales Rise in November." *MarketWatch*.

<<http://www.marketwatch.com/news/story/wal-marts-total-us-same-store-sales/story.aspx?guid=%7B78634EA3%2D9668%2D4E44%2DB86E%2D8B85639BD266%7D&dist=FSQ>>

³ Andrejczak, Matt. "Product Recalls for Toys and Other Items Up." *MarketWatch*.

<<http://www.marketwatch.com/news/story/report-says-product-recalls-toys/story.aspx?guid=%7B6CA6EF42%2DFEB8%2D47B5%2D92BB%2D9D4AE484361E%7D&dist=FSQ>>

⁴ "Wal-Mart's International Chief will Shape Future." *MarketWatch*.

<<http://www.marketwatch.com/news/story/wal-marts-international-chief-shape-future/story.aspx?guid=%7B92D0D4F9%2D9BAD%2D4D78%2D9AAC%2D225CA9ADE93C%7D&dist=FSQ>>

⁵ Ittner, John. "Wal-Mart to Buy Wind Power from Duke Energy." *Marketwatch*.

<<http://www.marketwatch.com/news/story/wal-mart-buy-wind-power-duke/story.aspx?guid=%7B34EC190F%2D8C1F%2D4953%2D9700%2DC014697F15BB%7D&dist=FSQ>>

⁶ "Wal-Mart Suspends Stock Repurchase Program." *Forbes*.

<<http://www.forbes.com/feeds/ap/2008/12/09/ap5800832.html>>

III. Industry Analysis

A. *Industry Overview*⁷

Wal-Mart operates a chain of discount stores, supercenters, and wholesale stores. According to Standard & Poor's, the company falls into the Consumer Staples sector and is classified into the sub-industry of Hypermarkets and Super Centers. Wal-Mart can also be classified as a discount retailer and is the largest company in terms of revenue.

Retailing can be defined as the sale of products from a specific location. Retailers operate by buying large quantities of products from manufacturers and sell these products in smaller quantities to customers. The retail industry can be categorized into two segments: department stores and general merchandisers. Department stores are establishments who retail a variety of merchandise from many different brand names but merchandise is arranged into separate departments. These types of businesses offer products ranging from apparel to home appliances to home furnishings but generally exclude food products.

General Merchandisers or "discounters" are stores that carry higher volumes of products and a more extensive variety of merchandise. Due to high competition, general merchandisers attract customers through discounts and therefore, these stores experience a higher traffic of customers. Wal-Mart took the discount business to a higher level in 1988 when it became the first company to introduce groceries and fresh products in its first supercenter store. A supercenter retails a combination of discount store merchandise and grocery products so that apparel, beauty products and even dairy, bakery, meat, and fresh products can all be found at the same store. Discounters also include wholesale retail stores or hypermarkets that are members' only stores and members typically include small business or frugal consumers. Wholesale stores offer lower prices than supercenter stores but charge dues to their members. These stores offer the same merchandise as supercenters but in bulk.

The Wal-Mart as we know it today has three business segments: Wal-Mart Stores, Sam's Club, and International. The Wal-Mart Stores segment is further broken down into supercenters, discount stores and neighborhood markets. Wal-Mart defines their supercenters as stores that offer a variety of general merchandise and a full-line supermarket with approximately 187,000 square feet. Their discount stores are defined as establishments with a wide variety of general merchandise but a limited assortment of food products with approximately 108,000 square feet. The neighborhood markets is a full-line supermarket but offers a limited assortment of general merchandise and with only 42,000 square feet.⁸

⁷ "Retailing: General." Standard & Poor's

⁸ Annual Report

Analysis of Competitive Forces – Michael Porter’s 5 Forces

Rivalry

The retail business is a highly competitive industry. Wal-Mart faces a number of competitors in all segments of their business. After being the first in the industry to build the first supercenter, Kmart and Target built supercenters as well. Discount stores were generally thought of as shopping centers for low-income consumers but this idea has changed. As retailers expanded their product lines, they included products for different customer incomes. Target, in particular, has generally been thought of as an upscale discount store as the company tends to target medium income consumers but their prices are usually higher than Wal-Mart’s.

Wal-Mart does not only face competition in their discount stores division but their wholesale division also faces competition from BJ’s and Costco. Sam’s Club, Wal-Mart’s wholesale division, is the #2 wholesaler in the nation while Costco remains #1 and BJ’s lags as #3. Costco operates about 545 membership stores and holds over 53 million members in 40 states as well as in Canada, Japan, Mexico, South Korea, Taiwan and the UK. BJ’s does not hold a large market share as it operates in the Northeast of US. BJ’s differentiates from Costco and Wal-Mart in that it targets individual customers instead of small businesses

To become an attractive option, Wal-Mart has developed their own brand names such as Garanimals® and OP®, which are apparel lines, and Canopy, a home brand thought to be at a higher level than their old Mainstays® line. Wal-Mart’s goal is to provide top-quality brands yet maintain their price leadership. The industry is delving into better customer service and building relationships with customers. These are important as the economy today is more competitive than ever since retailers are competing for tighter consumer wallets. On the other hand, discount stores benefit as consumers seek to save money when they cut down on discretionary spending and purchase staples only.

Threat of New Entrants

Being that the retail industry is a highly saturated market, new entrants would face difficulty succeeding in this industry. In fact, it is highly difficult for discount retailers to penetrate other markets as Wal-Mart tried to enter Germany and South Korea. The company was unsuccessful and had to pull out because of its unprofitability. Retailers are subject to these obstacles:

Economies of Scale – Smaller companies will struggle to attract new customers as this often involves sales, discounts or mark downs on items. Wal-Mart is better off than most companies because of its size. The company can afford to markdown prices when it wants to attract customers to the store. Once at the store, consumers may be attracted to other items and may purchase products without markdowns providing the company with higher margins. Wholesale clubs like Wal-Mart’s Sam’s Club offers even lower prices than supercenter because it makes up for the lower margins with membership fees.

Cost of Capital – In today’s credit crisis, banks are tightening lending standards and are deliberately choosing to lend less. Companies like Wal-Mart may be affected when they choose to borrow money to open new stores. Wal-Mart does not seem as affected since it has decided to transform discount stores into supercenters instead of building new stores.

The company transformed 104 discount stores into supercenters but only built 87 new supercenters in FY'08. We feel the company's decision is due not to tighter credit but because the company finds the supercenter their most profitable type of store. The fact that current credit conditions are tight and that banks are not making risky investments has led companies to face difficulties getting credit. These tight credit conditions will benefit Wal-Mart when their competition may try to expand their businesses or enter the market for the first time. The companies may not obtain credit or the loans needed for such an investment.

Distribution Channel – Some companies may face challenges in maintaining high inventory turnover, following inventory trends and building relationships with suppliers. Wal-Mart outperforms most companies in these areas as it enjoys higher inventory turnover than BJ's, and Costco but generally underperforms slightly than Target. In terms of building relationships with its distributors, Wal-Mart engages in purchase obligations and purchase orders with its suppliers. Purchase obligations are legally binding contracts to purchase inventory, which include specific terms such as whether the purchase is fixed or a minimum quantity, and most importantly, the price to be paid. This allows Wal-Mart to protect itself from future price markups from suppliers.

Threat of Substitute Products

Substitute products are products that can be used as replacements for other products to satisfy the same necessity. Wal-Mart benefits from this idea as discounters have lower prices than department stores and consumers go for higher quality product with the lowest prices. Macys and Wal-Mart may both sell apparel and bedding products but there is a major price difference between the two. When consumers are trying to save, they will substitute pricier Macy's items with lower priced Wal-Mart items. In making substitutions, consumers may have to forgo certain features such as the quality of the product, brand or even the service the store provides. Wal-Mart is working on providing the best customer service possible but as a high-traffic store, it is generally impossible to provide one-on-one service.

Bargaining Power of Suppliers

Forging relationships with suppliers is essential to Wal-Mart's business. Without timely inventory deliveries, Wal-Mart could not maintain its full shelves and would lose customers. For this reason, the company engages in contractual agreements with its suppliers. This arrangement is beneficial for both parties, as the supplier makes sure it will have constant access to retailers with large market share. This way, suppliers have a guaranteed buyer for the supplies and can arrange specific prices. Wal-Mart benefits by guaranteeing the cost of their merchandise and the timely deliveries, which will ultimately benefit consumers. Consumers will receive lower prices and an assortment of products.

Bargaining Power of Buyers

Consumers today are searching for the best deals possible. They are waiting for discounts and sales to bulk up on products. Discount retailers like Wal-Mart are creating huge supercenter stores because they want their stores to become a one-stop trip. This was most beneficial in 2007 as the high oil prices led consumers to shop less frequently to save gas. Instead of traveling from store to store in search for a variety of products, consumers can find them all in one location.

Customers know what they want and how far they are willing to search for the item. Retailers must maintain high inventory levels to retain customers and their market share. Customers traveling a couple of miles to a store want to find the products they need in stock. Stores must maintain high inventory levels on a timely fashion because if customers come in search for specific items, and it seems to be out of stock often, the customer will go elsewhere.

C. Analysis of Management Strategies Relative to the Industry

A notable trend in the retail industry is consumers buying less and less. Until about a year ago, consumers depended on credit cards. They did not hesitate to add to their already large debts but now consumers are trying to pay down debts instead. Wal-Mart's discount stores, supercenters and wholesaler clubs have maintained their price leadership strategy known as "Save money. Live better." This strategy was implemented in FY 2008 and is aimed at families with children and middle-income consumers trying to save.

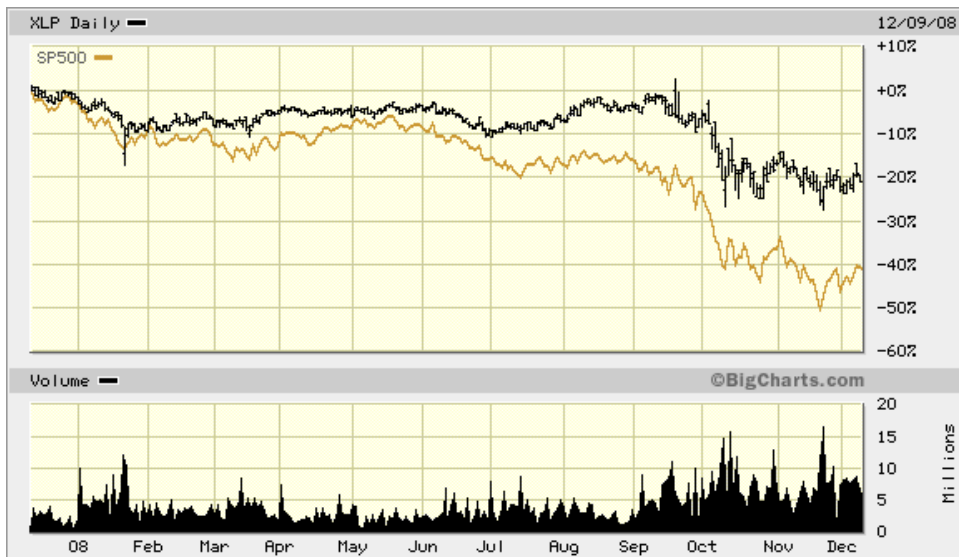
Wal-Mart is focusing on expanding its product line by including wellness products as well as environmentally – friendly products. With the high-energy prices facing consumers and the ideas of eating healthier and natural food, Wal-Mart has stocked products that would appeal to these consumers while maintaining its competitive prices. The company maintains a flexible management style where it is willing to satisfy changing demands. To meet demand, the company must encourage managers to monitor high demand products and drop unpopular product lines that may be a waste of inventory space.

As the country's demographics change where the Hispanic population has been increasing at a rate of 25% since 2000, Wal-Mart has appealed to those groups of people. In May 2008, the company opened its first supercenter in Texas to target the growing Hispanic population by including fresh produce, drinks and items like tortilla chips that are popular among this group. The company is also hiring bilingual employees to better serve customers in the area as well as providing Latino holiday parties in stores.⁹

Another trend is discounters' development of private labels. To compete with national brands, supermarkets and retailers have developed their own brands with the cooperation of manufacturers. These products are to be distributed and sold only in the retailers' stores.

⁹ "Supermarkets & Drugstores - Industry Trends" S&P NetAdvantage

D. Relative Industry Valuation



S&P 500 vs. Consumer Staples

The chart above shows how Consumer Staples have consistently outperformed the S&P 500 throughout 2008. It is important to note that as the year has progressed, the gap between the performance of the S&P 500 and Consumer Staples has widened.



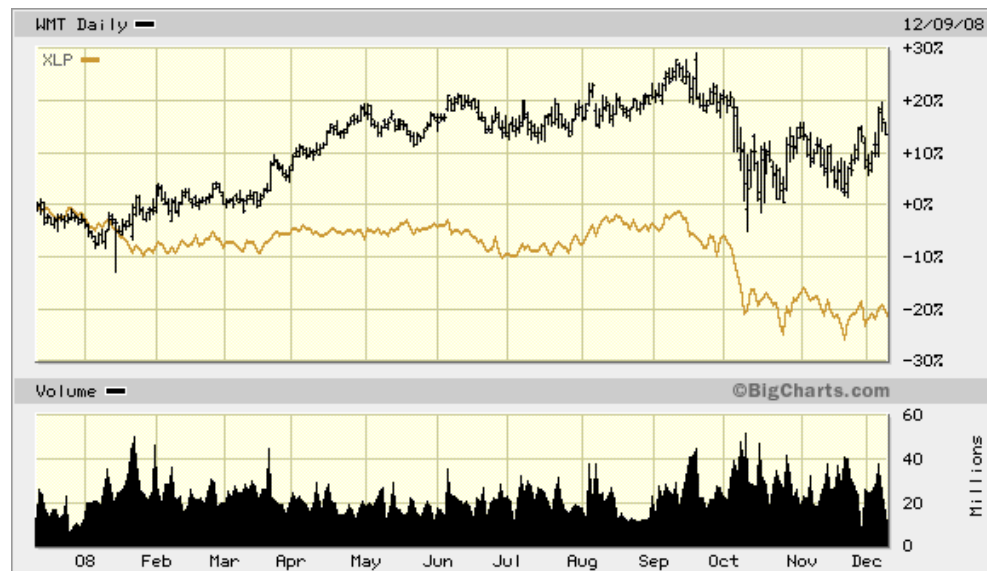
S&P 500 vs. Retail Industry

The chart above shows the retail industry's performance to the S&P 500 over the last year. The chart suggests the industry underperformed the S&P 500 towards the end of the year but was at the same level for most of 2008.



Wal-Mart vs. S&P 500

The chart above shows Wal-Mart's performance to the S&P 500 over the last year. The chart shows that not only has it outperformed the S&P 500, but also Wal-Mart's stock is up approximately 15% over the last year, while the S&P 500 is down nearly 40%.



Wal-Mart vs. Consumer Staples

The chart above shows Wal-Mart's performance compared to the Consumer Staples Sector of the S&P 500 over the last year. The chart suggests that Wal-Mart has significantly outperformed this sector.



Wal-Mart vs. Retail Industry

The chart above shows Wal-Mart’s stock performance over the last year compared to the performance of the Retail Industry. Once again, Wal-Mart’s return is considerably higher than that of the Retail Industry.

IV. Fundamental Analysis

A. Ratio Analysis

Profitability Ratios

Return on Equity: Return on Equity is used to measure how much profit has been made from using shareholders equity. For the last five years (from 2003 to 2007), Wal-Mart's ROE outperformed its rivals and the whole industry. Wal-Mart's ROE remained greater than 21%, while Costco's and BJ's ROE never reached 15%; the highest ROE level that Target could reach was 18.7%.

	2003	2004	2005	2006	2007
Wal-Mart	21.330%	22.537%	22.245%	21.226%	20.421%
Costco	11.856%	12.641%	12.177%	12.070%	13.378%
Target	15.700%	15.600%	17.700%	18.700%	18.400%
BJ's	13.157%	13.016%	13.851%	9.132%	12.138%
Industry	14.925%	16.071%	17.523%	18.397%	17.609%

Return on Assets: ROA measures how efficient management is at using assets to generate earnings. Similar to ROE, Wal-Mart's ROA outperformed its peers and the industry for the last five years. This makes Wal-Mart an attractive target to investors.

	2003	2004	2005	2006	2007
Wal-Mart	8.852%	9.104%	8.832%	8.405%	8.157%
Costco	5.861%	6.470%	6.403%	6.140%	6.147%
Target	5.395%	5.918%	7.157%	7.702%	6.954%
BJ's	6.545%	6.454%	6.977%	4.668%	6.011%
Industry	6.615%	7.109%	7.166%	7.525%	6.986%

Gross Margin: Gross Margin is a measure of mark-up over cost per dollar of sales. Wal-Mart's gross margin is better than Costco's and BJ's. Although it is not as high as Target's, the trend for the last five years is that Wal-Mart's gross margin has increased over years while Target's gross margin began to decrease in 2007.

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	22.464%	22.939%	23.077%	23.432%	23.499%	23.601%
Costco	12.439%	12.560%	12.415%	12.288%	12.429%	12.257%
Target	28.117%	28.604%	29.472%	30.069%	29.946%	28.302%
BJ's	10.088%	10.275%	10.493%	10.155%	9.944%	9.750%
Industry	23.655%	23.764%	23.839%	24.769%	21.500%	

Net Profit Margin: Net Profit Margin measures how much out of every dollar of sales a company actually keeps in earnings. A company with high net profit margin indicates that it has better control over its costs. In this category, Wal-Mart outperforms Costco, BJ's and industry, but lags behind Target.

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	3.458%	3.600%	3.693%	3.530%	3.431%	3.273%
Costco	1.722%	1.977%	1.932%	1.726%	1.747%	1.745%
Target	3.852%	4.024%	4.576%	4.683%	4.494%	4.083%
BJ's	1.570%	1.581%	1.710%	1.100%	1.350%	1.320%
Industry	2.358%	2.618%	2.707%	2.812%	2.700%	

Short-Term Solvency

Current Ratio: The ratio gives investors an idea of the company's ability to pay back its short-term liabilities with its short-term assets. The higher the ratio, the more likely a company is able to pay off its short-term obligations. Wal-Mart has the lowest current ratio when compared to its competitors because of its heavy reliance on short-term debt and commercial paper to finance its operations.

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	0.910	0.900	0.898	0.901	0.814	0.902
Costco	1.163	1.235	1.166	0.955	1.055	1.066
Target	1.558	1.694	1.502	1.323	1.605	1.639
BJ's	1.193	1.250	1.299	1.234	1.210	1.237
Industry	1.340	1.337	1.301	1.145	1.101	

Quick Ratio: The ratio measures the firm's ability to meet short-term obligations with its most liquid assets (current assets excluding inventory). The higher the ratio, the better a company's short-term liquidity is. Wal-Mart has the lowest quick ratio of its competitors because of its considerable dependence on current liabilities.

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	0.312	0.211	0.244	0.255	0.212	0.258
Costco	0.511	0.644	0.576	0.386	0.484	0.498
Target	1.013	1.039	0.894	0.760	1.029	0.995
BJ's	0.262	0.34	0.356	0.253	0.283	0.317
Industry	0.608	0.613	0.606	0.482	0.478	

Debt Ratios

Under this category, Wal-Mart seems very volatile. The firm relies on long-term debt to finance its business, which can be extremely dangerous because the current economic environment has made it difficult for companies to receive new financing. Of its three competitors, Wal-Mart is only in better position than Target in terms of finance leverage.

LT Debt-to-Equity: This is to measure the firm's financial leverage. The higher the ratio, the riskier the firm. Under this category, Wal-Mart is not as risky as Target. However, it borrowed more money proportionally to equity during the last five years than Costco and BJ's.

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	46.074%	47.085%	56.602%	49.916%	51.699%	56.461%
Costco	19.674%	13.679%	8.002%	2.355%	24.445%	23.998%
Target	91.223%	69.338%	64.196%	55.492%	98.818%	133.254%
BJ's	1.770%	1.285%	1.072%	1.670%	1.259%	1.125%
Industry	63.627%	57.938%	55.797%	56.292%	54.720%	

Financial Leverage: This ratio is calculated by dividing total equity by total assets. The lower the number, the less debt the firm is using to conduct its business. Again, Wal-Mart is not as debt-dependent as Target. However, Costco and BJ's growth does not depend on debt as much as Wal-Mart.

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	2.416	2.432	2.599	2.462	2.531	2.499
Costco	2.012	2.077	1.876	1.913	2.274	2.250
Target	2.822	2.479	2.464	2.389	2.911	3.354
BJ's	2.020	2.014	1.959	1.954	2.087	2.045
Industry	2.764	2.715	2.645	2.712	2.451	

Time Interest Earned: This ratio measures how well a firm covers its interest obligation. Under this category, Wal-Mart seems extremely volatile. For the last five years, its TIE has decreased, which means that Wal-Mart's ability to service debt is declining. This trend has continued even though the whole industry has moved in the opposite direction.

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	15.250	14.784	13.349	11.485	10.604	10.340
Costco	34.79	39.91	74.895	269.554	20.666	20.136
Target	5.682	6.146	8.878	8.528	7.913	5.495
BJ's	227.262	242.213	378.774	233.630	314.438	676.793
Industry	8.931	10.358	10.620	9.825	9.139	

Efficiency Ratios

Asset Turnover: This ratio measures the amount of sales generated for every dollar worth of assets. Asset turnover measures a firm's efficiency at using its assets in generating sales. Based on the Asset Turnover ratios of Wal-Mart and its competitors, Wal-Mart is less efficient than Costco, BJ's and the industry at using its assets to generate sales. This is understandable since Wal-Mart's strategy is to drive the price down as much as possible so that consumers can save on their items. Although Costco and BJ's sell wholesale, they benefit from membership fee, which is why their asset turnover is higher than Wal-Mart's.

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	2.561	2.496	2.392	2.381	2.377	1.171
Costco	3.404	3.272	3.314	3.557	3.519	1.896
Target	1.400	1.470	1.564	1.645	1.547	0.688
BJ's	4.180	4.083	4.078	4.258	4.458	4.782
Industry	2.822	2.767	2.774	2.793	2.666	

Inventory Turnover: Inventory Turnover shows how many days it takes a company to sell its inventory. A high inventory turnover can mean weak sales or possibly poor inventory management. Wal-Mart's inventory turnover is lower than Targets but higher than Costco, BJ's, and the industry average. The reason for the high inventory turnover rate is that Wal-Mart's management has put great emphasis on ensuring that all stores are well-stocked at all times.

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	48.873	49.424	47.36	45.319	43.865	42.688
Costco	33.515	33.235	30.971	30.693	31.201	26.719
Target	56.129	54.110	55.185	53.045	53.003	58.666
BJ's	40.663	40.516	40.526	39.862	38.896	34.633
Industry	41.86	43.761	40.474	39.608	39.586	

Receivables Turnover: Wal-Mart is the best in this category although since 2004, it has taken Wal-Mart increasingly longer to collect its receivables. However, the time it spends (average 2.574 days for the last five years) is much less than the industry average (12.321 days). Costco and BJ come close (3.16 days and 4.219 days, respectively).

	2003	2004	2005	2006	2007	2008 (YTD)
Wal-Mart	2.01	1.9	2.534	2.865	3.561	2.981
Costco	3.07	2.389	2.498	3.525	4.32	3.242
Target	44.234	37.755	37.232	36.383	41.034	47.001
BJ's	3.873	4.113	4.352	4.367	4.392	3.972
Industry	12.646	12.156	12.118	11.983	12.701	

DuPont Analysis

Return on Equity = Asset Turnover * Net Profit Margin * Financial Leverage

$$\frac{\text{Net Income}}{\text{Equity}} = \frac{\text{Sales}}{\text{Average Assets}} * \frac{\text{Net Income}}{\text{Sales}} * \frac{\text{Average Assets}}{\text{Equity}}$$

FY 2007

$$\frac{\$12,849}{\$63,090} = \frac{\$347,368}{\$157,550} * \frac{\$12,849}{\$374,368} * \frac{\$157,550}{\$63,090}$$

$$.20421 = 2.37719 * .03432 * 2.49723$$

$$.20421 = .20421$$

FY 2006

$$\frac{\$12,178}{\$57,372} = \frac{\$344,922}{\$144,887} * \frac{\$12,178}{\$344,922} * \frac{\$144,887}{\$57,372}$$

$$.21226 = 2.38063 * .03531 * 2.52540$$

$$.21226 = .21226$$

FY 2005

$$\frac{\$11,408}{\$51,283} = \frac{\$308,945}{\$129,170} * \frac{\$11,408}{\$308,945} * \frac{\$129,170}{\$51,283}$$

$$.22245 = 2.39177 * .036926 * 2.51877$$

$$.22245 = .22245$$

FY 2004

$$\frac{\$10,267}{\$46,509} = \frac{\$285,221}{\$112,780} * \frac{\$10,267}{\$285,221} * \frac{\$112,780}{\$46,509}$$

$$.22537 = 2.49591 * .03599 * 2.42491$$

$$.22537 = .225375$$

FY 2003

$$\frac{\$8,863}{\$41,480} = \frac{\$256,329}{\$100,107} * \frac{\$8863}{\$256,329} * \frac{\$100,107}{\$41,480}$$

$$.21330 = 2.56055 * .03457 * 2.40977$$

$$.21300 = .21300$$

	Return on Equity	Asset Turnover	Net Profit Margin	Finance Leverage
FY 2007	0.20421	2.37719	0.03432	2.49723
FY 2006	0.21226	2.38063	0.03531	2.52540
FY 2005	0.22245	2.39177	0.03693	2.51877
FY 2004	0.22537	2.49591	0.03599	2.42491
FY 2003	0.21330	2.56055	0.03457	2.40977

The DuPont Analysis calculates Return on Equity by multiplying Asset Turnover, Net Profit Margin, and Financial Leverage. Over the last five years, Wal-Mart's Return on Equity has decreased. From the DuPont model, we can see that the main reason for this drop is a decrease in Asset Turnover.

B. Income Statement Forecast

	2006	2007	2008 (YTD)	2009 (EST)
Sales Revenue	\$344,992	\$374,526	\$293,248	\$451,552
Total Revenue	\$348,650	\$378,799	\$296,491	\$456,509
COGS	\$264,152	\$286,515	\$223,587	\$343,751
Gross Profit	\$80,840	\$88,011	\$69,661	\$107,801
SGA	\$64,001	\$70,288	\$56,513	\$87,878
Operating Income	\$10,474	\$10,815	\$7,962	\$19,923
Interest Income	\$280	\$305	\$216	\$148
Interest Expense	(\$1,809)	(\$2,103)	(\$1,624)	(\$2,054)
Net Interest Income	(\$1,529)	(\$1,798)	(\$1,408)	(\$1,906)
Other Income	\$3,658	\$4,273	\$3,243	\$4,957
EBT	\$12,606	\$13,290	\$9,800	\$22,974
Income Taxes	\$6,365	\$6,908	\$5,186	\$8,040
EAT	\$12,603	\$13,290	\$9,797	\$14,932
Minority Interest	(\$425)	(\$406)	(\$365)	(\$452)
Net Income	\$12,178	\$12,884	\$9,432	\$14,481
Diluted Shares	\$4,168	\$4,072	\$3,962	\$3,955
EPS	\$2.92	\$3.16	\$2.38	\$3.66

In order to forecast Wal-Mart's income statement for 2009, the first thing we had to do is forecast Wal-Mart's market share. Based on previous recessionary periods, we estimated that Wal-Mart's market share would increase by around 2% to 46.5% in 2009. From this, we forecasted that Wal-Mart's total revenue would be \$456.5 B. We then estimated 2009 COGS as a percentage of total revenue. The percentage we used was 75.30% and it is based on the fact that COGS as a percentage of total revenue has been steadily decreasing since 2000. For SGA, we forecasted \$87.9 B based on the fact that Wal-Mart's SGA has increased by .34% of total revenue year over year since 2002. Interest income was based on forecasting 2.5% interest rates and interest expense was forecasted using average long-term date rate, commercial paper rate, and rate on current liabilities. We believe that 2.5 % is reasonable because the economy will struggle in 2009 and therefore interest rates will remain low. The other income refers to membership fees paid at Sam's Club. This has grown at an average of 16% over the last six years and we feel that it will continue to grow at this level because people will look for the value in wholesale during these tough economic times. We forecasted Wal-Mart's income tax rate to remain steady at 35%. Although Obama has stated he will raise corporate taxes, we believe he will not raise them in 2009 because of the economic condition. For minority interest, which are dividends paid to preferred stockholders of international operations, we found that on average, minority interest is the equal to .1% of sales revenue. Based on all of this information, we have forecasted that Wal-Mart's 2009 earnings per share would \$3.66.

C. Valuation Models

Relative Valuation

A relative valuation allows us to derive Wal-Mart stock price based on its Price-to-Earnings relationship with Costco, Target, BJ's, the Industry and S&P 500 Consumer Staples Index.

P/E	2000	2001	2002	2003	2004	2005	2006	2007	2008	Mean	Median
									(as of Dec.2)		
Wal-Mart	35.689	41.691	27.311	29.36	21.465	16.643	16.317	16.053	15.508	24.44856	21.465
Costco	31.185	31.391	20.412	23.587	22.631	23.187	24.515	23.385	16.798	24.12122	23.385
Target	27.398	29.574	15.59	21.555	24.568	20.188	19.117	16.605	8.809	20.37822	20.188
BJ's	24.124	42.933	7.476	14.463	17.216	16.359	21.957	17.131	15.541	19.68889	17.131
Industry Avg	32.474	30.131	19.944	29.663	24.52	24.662	20.952	17.762	11.686	23.53267	24.52
S&P 500-CS	25.925	26.521	19.343	21.238	20.728	20.623	25.636	20.018	13.863	21.54389	20.728

The year of 2001 seems to be the best year for the whole industry since all the P/E's reached their highs. The reason for this is that there was a recession in 2001 and 2002, leaving consumers no choice but to shop at discount stores or wholesalers.

The situation became worse after 2004, when the economy started to expand. Consumers had more options, making the companies in the industry disappear from consumers' top list. However, during the last two quarters of 2008, as the economy heads toward another recession, consumers are once again watching their budgets, making Wal-Mart's third quarter report better than expected.

The fact that Wal-Mart's P/E is lower than and the industry average may mean that Wal-Mart is currently undervalued. In order to find out if Wal-Mart's stock is undervalued or overvalued, determining the price range at which the stock should be trading is essential. It is determined by the following formula:

$$(\text{Benchmark P/E}) * (\text{"Adjustment Factor"}) * E[\text{EPS}]$$

While benchmark P/E can be easily tracked using FactSet and the E[EPS] is based on our income statement forecast, the "adjustment factor" is determined as follows.

	2000	2001	2002	2003	2004	2005	2006	2007	2008 (as of 12/2)	Mean	Median
Wal-Mart/Ind Avg	1.099	1.384	1.369	0.990	0.875	0.675	0.779	0.904	1.327	1.045	0.990
Wal-Mart/SP500-CS	1.377	1.572	1.412	1.382	1.036	0.807	0.636	0.802	1.119	1.127	1.119
Wal-Mart/Costco	1.144	1.328	1.338	1.245	0.948	0.718	0.666	0.686	0.923	0.9997	0.948
Wal-Mart/Target	1.303	1.410	1.752	1.362	0.874	0.824	0.854	0.967	1.760	1.234	1.303
Wal-Mart/BJ's	1.479	0.971	3.653	2.030	1.247	1.017	0.743	0.937	0.998	1.453	1.017

Wal-Mart's P/E relative to Costco's decreased from 2000 to 2006. However, it increased in 2007 and has increased in 2008. Therefore, the best "adjustment number" is the average of all those numbers. Similarly, Wal-Mart's P/E relative to Target's has been moving up and down since 2000; therefore, the best "adjustment factor" is also the average of those numbers. Wal-Mart's "adjustment factor" to BJ's is the median. The "adjustment factor" for the industry average and S&P500-CS are the 2008 numbers, while the "adjustment factor: for the S&P 500-CS P/E Average is the mean.

With Wal-Mart's estimated earnings per share for 2008 being \$3.66, the average relative value of Wal-Mart becomes \$56.17. As of 12/05/2008, Wal-Mart stock closed price is \$58.21, making its price relatively fairly valued.

		Adjustment		
	P/E (FY2)	Factor	E[EPS]	Price
Costco	14.132	0.999645	\$3.66	\$51.70
Target	9.81	1.233902	\$3.66	\$44.30
BJ's	15.041	1.01736	\$3.66	\$56.01
Industry Avg	10.414	1.327058	\$3.66	\$50.58
S&P 500-CS	11.128	1.118661	\$3.66	\$45.56
S&P 500-CS P/E Avg	21.54389	1.126959	\$3.66	\$88.86
Average Price				\$56.17

Absolute Valuation

Absolute Valuation models specify an asset's intrinsic value by supplying a point estimate of value that can be compared with the market price. In Wal-Mart's situation, the dividend growth model is used to determine the future value of Wal-Mart stock. This price is then discounted to the present value to compare with the price of the stock.

The first step in absolute valuation model is to determine cost of capital. There are two ways to determine the cost. The first way is to use Capital Asset Pricing Model (CAPM).

10-year Treasury Strip (Risk-Free Rate)	3.923%
Beta	0.143
Return on the Market	9.723%
Market risk premium	5.8%
CAPM	$3.923\% + 0.143 * 5.8\%$
K1	4.7524%

The second way is to use Wal-Mart 10-year bond. Wal-Mart has one bond that matures in 2018 with a yield to maturity of 5.8%. During normal economic periods, we would have added an equity over bond premium of 3% to the 5.8% to determine the cost of capital. However, because of the current economic situation has added significant risk to the market, we decided to add 3.5% to the yield and calculated the cost of capital to be 9.30%.

We decided that the most accurate cost of capital would be 9.30% because the CAPM result of 4.75% is lower than the yield of Wal-Mart's bond. The cost of capital cannot be lower than the cost of debt because investing in stocks is riskier than buying debt.

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008(e)	2009(e)
EPS	\$0.99	\$1.25	\$1.40	\$1.44	\$1.76	\$2.03	\$2.46	\$2.72	\$2.92	\$3.16	\$3.46	\$3.66
DPS	\$0.16	\$0.20	\$0.24	\$0.28	\$0.30	\$0.36	\$0.52	\$0.60	\$0.67	\$0.88	\$0.95	\$1.04
Growth Rate	16.16%	16.00%	17.14%	19.44%	17.05%	17.73%	21.14%	22.06%	22.95%	27.85%	27.46%	28.50%

In order to forecast the dividend growth rate for Wal-Mart over the next five years, we used the average retention rate and ROE for Wal-Mart from 2003-2007. From these calculations, we were able to forecast Wal-Mart's dividend growth from 2009 to 2013 at 16.001%.

Average Payout Ratio for the last 5 Years	22.34%
Retention Rate	77.66%
Average ROE	20.61%
Growth Rate	16.001%

Using 16.001% dividend growth rate, estimates for 2009-2013 dividends come out to be as followed.

	2009	2010	2011	2012	2013	Total
DPS	\$1.04	\$1.21	\$1.40	\$1.63	\$1.89	\$7.17
NPV @ 9.30%	\$0.95	\$1.01	\$1.07	\$1.14	\$1.21	\$5.39

At $K = 9.30\%$, net present value of five-year-forward dividends is \$5.39.

Scenario Analysis

		Dividends	PV of Dividends	Intrinsic Value
		Post 2013	Post 2013	as of 12/31/08
Growth Rate	2014 Dividend	$k = 9.30\%$	NPV @ 9.30%	NPV @ 9.30%
1.00%	\$1.91	22.98337312	22.08569686	\$27.48
2.00%	\$1.93	26.39051089	25.35975989	\$30.75
3.00%	\$1.95	30.87927971	29.673208	\$35.07
4.00%	\$1.96	37.06192354	35.61437238	\$41.01
5.00%	\$1.98	46.12021568	44.31886902	\$49.71
6.00%	\$2.00	60.66838184	58.29881818	\$63.69
6.85%	\$2.02	82.37187054	52.80537346	\$58.20
8.00%	\$2.04	156.9100964	100.5889048	\$105.98
9.00%	\$2.06	686.2395267	439.9212286	\$445.32

The growth rate column indicates the growth at which dividend will grow after 2013. If the growth rate is 6.85%, the dividend for the year 2014 will be \$2.02. At $K=9.30\%$ and at 6.85% growth, the future value of Wal-Mart stock in 2013 will be \$82.47. By discounting this price back 5 years at the rate 9.30%, the present value of stock is \$52.80 per share. We then added \$5.39 (the present value of the dividend from 2009-2013), and found Wal-Mart stock's intrinsic value to be \$58.20. This means that investors are currently forecasting that Wal-Mart's dividend will grow at an average of 6.85% after 2013.

Based on this information, we must evaluate how likely it is that the growth rate after 2013 will be above or below 6.85%. If we believe that rate will be higher than the stock is undervalued, but if we believe the rate will be lower than the stock is overvalued. From the information we gathered on Wal-Mart and its future prospects, we feel an average growth rate of 6.85% after

2013 is an accurate estimate. Although we estimate a 16% growth rate until 2013, we feel that this growth rate is not sustainable for two primary reasons: saturation of the U.S. market and difficult penetrating new international markets.

Currently Wal-Mart in the United States is primarily focused on converting discount stores to supercenters rather than building new stores because they are having difficulty finding new places to build. Although the conversion of discount stores to supercenters is creating revenue growth, by 2013 most discount stores that have the ability to be converted to supercenters will have been converted. This fact leaves Wal-Mart with a major void in terms of revenue growth. After 2013, Wal-Mart will need a new strategy to create growth and currently there are no plans that will replace the growth created by store conversions.

The second reason we believe that Wal-Mart's growth will slow is its difficulty in penetrating new international markets. Wal-Mart had so much difficulty with its stores in Germany and South Korea that they were forced to sell their operations in these countries. In addition, Wal-Mart at the moment does not have any plans to expand into new countries. It is also important to note that currency exchange could greatly impact earnings in its international operations.

D. Risk Factors

Being the world's largest public corporation by revenue, Wal-Mart faces a lot of risks. Some risks are industry-related while others are unique to Wal-Mart.

The first risk that Wal-Mart has to face is currency exchange. For fiscal year ended 01/31/2008, Wal-Mart's international sales topped \$90,640 million (a 17.5% increase year-over-year) and accounted for 24.2% of total net sales. This means that Wal-Mart is increasingly conducting more business offshore. The company benefited a lot in 2007 when the U.S. dollar depreciated in value. However, Wal-Mart's 2008 third quarter report indicated that the risk that Wal-Mart is facing now is the strengthening of U.S. dollar, which will cut into Wal-Mart's profit internationally when the foreign currency are exchanged into U.S. dollars.

The second risk that Wal-Mart has to face is "Obama Effect," which is shared by all other businesses. It is likely that under Obama's presidency, corporate taxes will be higher than they are right now. A slight drop in bottom line growth is expected.

The third risk that Wal-Mart has to share with the industry is the safety of products. According to WalMartWatch.com, big retailers such as Wal-Mart and Toy 'R' Us played a major role in the toy safety crisis in the beginning of 2008. "As it stands, Wal-Mart relies on a single laboratory for its product safety testing. The lab - Consumer Testing Laboratories in Bentonville, Ark. - is paid by Wal-Mart for its services, raising some questions about the lab's objectivity."¹⁰

Also, in September and October, Wal-Mart China suffered a major setback: they were forced to pull dairy products from Chinese stores for melamine fears. With a huge chunk of business conducted in China, Wal-Mart now is vulnerable to product safety concerns, which will make the company invest more in food safety investigation and testing. All the new procedures and tests will affect the firm's bottom line.

Wal-Mart's first unique risk is the saturation of the U.S. market. Wal-Mart became a huge success in the 1970s, 1980s and 1990s since it introduced a new concept: one stop shop. With this success, came rapid expansion. Wal-Mart is currently having difficulty finding new markets in the United States and has now turned to making its current stores larger in order to promote revenue growth. For the fiscal year ended 2008, only 87 new supercenters were opened, while 104 discount stores were converted into supercenters.

Another risk Wal-Mart fact is when the economy begins to grow and consumers have more discretionary income, they tend to buy their goods at other stores than Wal-Mart. As a result, during period of economic growth, Wal-Mart's market share declines as witnessed earlier in the decade when Wal-Mart's market share in our custom industry went from 47.6% in 2003 to 45.3% in 2007. During this period, the U.S. went from recession to economic prosperity.

Another risk that Wal-Mart must face is difficulty penetrating foreign markets. Wal-Mart first entered Germany market in 1997. In 2006, it was forced to sell all of its German stores to its main European rival, Metro AG. Also in 2006, Wal-Mart had to leave the South Korean market. It agreed to sell its 16 South Korean outlets to Shinsegae, a local retailer, for \$882 million.

¹⁰ http://walmartwatch.com/blog/archives/toy_safety_concerns_persist_at_wal_mart/

E. Investment Drivers

At the current moment, Wal-Mart's biggest investment driver is the economic slowdown currently occurring worldwide. Why? It is due to Wal-Mart's slogan "Save money, live better." During recessionary periods consumers tend to cut back on expenses. As a result, consumers turn to Wal-Mart to buy their goods at a discounted price.

In the third quarter of 2008, the real GDP decreased at an annual rate of 0.5 percent. Non-farm payroll employment fell sharply (533,000) in November, and the unemployment rate rose from 6.5 percent to 6.7 percent. November's drop in payroll employment followed declines of 403,000 in September and 320,000 in November. This information shows that purchase power will decline, and as a result, more consumers will flock to Wal-Mart stores.

V. Conclusion

From this analysis of Wal-Mart, we have concluded that Wal-Mart's stock is fairly priced and therefore the St. John's Student Managed Investment Fund should not buy Wal-Mart's stock. Wal-Mart is a great company that does well during these recessionary times. Realizing this fact, investors have flocked to Wal-Mart as a sort of safe haven during these tough economic times, which has resulted in Wal-Mart's stock price appreciating by 15% year-to-date. This coupled with the fact that we expect Wal-Mart's growth to eventually begin to slow has resulted in Wal-Mart's stock going from undervalued to fairly-valued over the course of this past year.