Walmart: A Retail Behemoth?

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Walmart, headquartered in Bentonville, Arkansas, is the world's largest retailer. Founded in 1962 by Sam Walton, Walmart operates a chain of hypermarkets, discount department stores, and grocery stores. It operates over 10,500 stores in 24 countries and has e-commerce operations in 10 countries. However, the US still currently accounts for more than 80% of its revenues with there being stores present in all 50 states. Puerto Rico also offers low prices on the broadest assortment of products through a variety of formats including the Supercenter, Discount Store and Neighbourhood Market.

Key Business Divisions are:

- **Walmart US:** This is the largest division inside Walmart makes up around 76% of its operating profit. In the United States, 90% of the US population resides within 10 miles of a Walmart store giving it significant scale advantages over competition. Hence, the US is the most profitable division of Walmart with an operating margin of around 5%.

- **Walmart International:** This division accounts for 18% of total revenues and 17% of its operating profit. Walmart International has more than 5,400 retail units around the world and has operations in various countries like Mexico and Central America Canada, China, India, Africa etc. Current operating margins are around 4.3% and there is room for improvement as business scales.

- **Sam's Club:** This division accounts for 13% of total revenues and 7% of its operating profit. Sam Walton opened the first Sam's Club in 1983 to help small business owners save money on merchandise purchased in bulk. Since then, Sam's Club has grown rapidly to serve families and entrepreneurs through nearly 600 clubs in the U.S., more than 200 international clubs, SamsClub.com and mobile applications.

Majority of Walmart's revenues are generated from retail sales via its physical stores and e-commerce platforms, selling a wide range of products including groceries, apparel, electronics, and household goods. Grocery accounts for almost 60% of Walmart US's sales, followed by General Merchandise at 26% and Health & Wellness at 12%. Walmart accounted for ~ 20% of the North American grocery market in 2023 followed by Amazon (18%) and Kroger (10%). On the merchandise side, Walmart's share is low (3%) vs Amazon (14%), thus providing it a huge opportunity to grow. Additionally, Walmart has been trying to diversify its revenue streams by offering membership programs, marketplace services, financial services etc.
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- Membership Programs: Walmart is a subscription service that offers benefits like free shipping and discounts on fuel.

- Marketplace Services: Walmart Marketplace allows third-party sellers to list their products on Walmart's website, generating additional income through referral fees.

- Financial Services: Walmart offers various financial services including money transfers, check cashing, and credit cards.

Investment Highlights:

- **Grocery business continues to outperform peers:** Walmart has been able to infuse fresh momentum in its grocery business over the last couple of years with its grocery comps significantly outperforming peers. Walmart registered a mid-single-digit growth in F4Q on top of mid-teens growth last year. It's price leadership along with convenience given its pickup / delivery services has helped it gain wallet share (dollar as well as unit share) from its customers. Higher inflation is also attracting relatively higher income household to Walmart. This shift to value grocers like Walmart could continue as consumers are still adjusting to higher prices.

- **Share Gains in General Merchandise:** This is a huge opportunity for Walmart given its low share. Share gains in this segment should continue given support from remodels (928 planned in F25 incl. 650 in the US), online SKU expansion (including through 3P) and other initiatives. Walmart has been expanding its marketplace with more SKUs. This along with various delivery options for consumers is helping it gain market share amongst high- income consumers who tend to spend more on general merchandise and are currently looking for value. Also, overall cooling of food inflation could also help to ease pressure on higher-margin discretionary spending.

- **Margin expansion:** Walmart has made huge investments over the last few years on Wages and supply chain which should enable it to grow sales faster than costs over the next 3-5 years. Increased contributions from higher-margin profit streams (digital advertising, 3P marketplace and fulfillment services) should also bolster margins. Growth in market share in the general merchandise segment would also help profitability given the higher margin nature of the business. Walmart also continues to work towards lowering ecommerce losses and increasing 1P profitability by leveraging stores (with last mile store-to-home delivery costs down significantly in F24). Walmart could reach 6% operating margin over the next 3-5 years.

- **Impressive momentum in Digital Space:** The company reported global eCommerce growth of 21% and US eCommerce growth of 22%. Online grocery along with marketplace ramping is accelerating e-commerce penetration for lower-income consumers. This should continue unlocking higher-margin profit streams for WMT including digital advertising which is now USD 3.4 billion in F24. Walmart expects digital momentum to continue and is looking at a growth rate of 15-20% going forward.

- **Increased contribution from higher margin Alternative Profit Pools:** Walmart's assortment upgrades, its 3P offerings etc is providing an opportunity to offer higher margin Walmart fulfillment services, consolidation orders thus reducing cost per delivery, and earning fees along the way. Walmart's advertising effort with Walmart Connect has good potential given its strategic relevance for vendors to access Walmart's consumers. Also, Walmart+ (Walmart's membership program) that provides benefits like free same day grocery delivery (USD 35 minimum order), free shipping on general merchandise items, fuel savings etc is attracting more users on the platform and also increasing their order size.

Key Risks:

- **Tougher Comparisons:** Walmart delivered stronger comp sales & traffic growth vs. peers in 2023 implying tough comparisons in 2024. On top of that waning food inflation could lead the consumer shift away from value grocers like Walmart. Discretionary spending could continue to remain weak as consumers continue adjusting to higher grocery prices.

- **Erosion in share gains/customer traffic:** If competition ramps us promotions/price investments, this could lead to a less rational retail environment which could pressure sales/margins for the broader industry.

- **Margin erosion:** Higher-margin discretionary spend could continue to ace headwinds if the economy continues to slow, thus pressuring margins. Walmart might be force to make more investments in e-commerce thus delaying its path to profitability. Long-term profitability could be pressured by continued investments in digital/omni-channel, supply chain/automation and other strategic priorities.

- **Economic slowdown:** The company is highly dependent on the consumer and many of Walmart's core customers are in the economically sensitive income demographics. Thus, any change in the buying power of these consumers may have an adverse impact on Walmart's revenues.

Financials and Valuation:

Walmart is targeting 4%+ top line growth and 4-8% operating income growth long-term. However, currently the business momentum is really strong and the business could deliver even a double-digit operating income growth in 2024/25. In 2Q, the company's US comp of 4.2% accelerated from 1Q, driven by traffic growth. eCommerce momentum is also pretty strong with 20%+ growth in revenues. Improvement in profitability driven by efficiency gains as well as capex along with strong topline growth will be the key drivers of this profitability. Also, capex is likely to come down going forward leading to strong cash flow growth which could lead to high dividend payout or additional buybacks going forward.

Recommendation:

Figure 1. Price Chart of Walmart, Source: Bloomberg (Data as of 25th Sep, 2024)

Walmart stock has risen almost 50% this year. Its valuation is unlikely to expand meaningfully from here given that its current ~25x 2-year forward P/E is already slightly above its 5-year average of 22x. However, the business is displaying robust momentum across its all three segments. Interestingly, it is happening at a time when the economy is showing signs of slowdown. The retailer has built enough capabilities over the years and is now much more in control over its destiny than it did in the past.

Company could deliver almost double-digit earnings growth over the next few years driven by better-than-expected consumer spending growth, ecommerce acceleration, greater contribution from advertising, international expansion, and/or further retail share consolidation.

Additionally, Walmart offers a nice mix of defensiveness and aggressiveness in these difficult times. **To me, Walmart is a core holding for any portfolio and should be bought on every dip.**

Other notes:

Short interest as a percentage of free float is quite low at around 1.4%. Technically, the stocks is in an overbought territory with RSI at 59 levels. The stock is trading almost 25% above its 200-day average, which is likely to cap its upside in the short-term. Moreover, a three-month at-the-money call option is priced at approximately 5% which seems slightly expensive.

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Abstract

Across the years, Nike has most definitely established itself as a leader in the athletic footwear and apparel brand industry. However as of late, the company has faced significant challenges

especially with its heavy reliance on direct-to consumer (DTC) sales. However, this shift had its own downsides with reduced product innovation, rising competition and bloated inventories. This has allowed competitors such as On, Hoka and Adidas to be almost on par with Nike in certain aspects. The newly appointed CEO Elliot Hill is trying to address the shortcomings ofNike by focusing on innovation, wholesale relationships, and R&D. However, in the long run, I believe that the company is positioned for a turnaround making Nike stock an attractive option for a gradual investment.