J.P.Morgan

Wal-Mart Stores, Inc.

Back To The Future, 6 Analyst Day Highlights

Overweight

WMT, WMT US

Price: $53.82

Price Target: $58.00

After our excursion down to Bentonville for Wal-Mart's Analyst Day today (10/13), we left with mixed emotions. To explain, on a positive note, for the most part, we liked what we heard from U.S. CEO Bill Simon (in particular, addressing what went "wrong" over the past 12-18 months and taking steps to correct these mistakes) and certainly felt the Sam's presentation was the best in years. In addition, it was great to learn that Seiyu (Japan) is finally profitable with sales moving in the right direction. That said, we're a bit concerned that the company isn't addressing the dollar store dilemma that has emerged and didn't like to hear that inventory would track higher than sales over the next few quarters. Finally, although we weren't anticipating a big uptick in comps in 3Q, we held out some hope that sales had improved, which based on commentary during the store visits and sidebar chats was clearly not the case. All told, we're remaining Overweight the stock given its cheap valuation, but the rubber is going to hit the road soon (i.e. 4Q) as inventory builds and excess FCF gets repositioned towards acquisitions in lieu of share repurchases, which have meaningfully supported EPS over the past 1-2 years.

- **Take #1: Similar To Costco . . . SSS Improving at Sam's Club.** During the meeting, Sam's surprisingly increased its 3Q SSS guidance by 100 bps to +1% to +3% from flat to +2%. Encouragingly, improving traffic trends are the driving factor behind the comp gains. CEO Brian Cornell attributed the increased frequency to **(1)** upgraded merchandise, **(2)** successful in-store food demo's (now testing non-food demo's in 150 stores), **(3)** increased wallet share of plus members through eValues, and **(4)** mix changes through remodeled stores. By year-end, over 100 stores will be remodeled into the Project Portfolio format, which expands sq. ft. in highly productive areas such as meat, produce, baby and HBA. Additionally, Plus membership penetration has improved 30% YTD on top of a 45% increase last year; being driven by special events, online messaging, and increased customer engagement in-store.

Broadlines & Food Retailing

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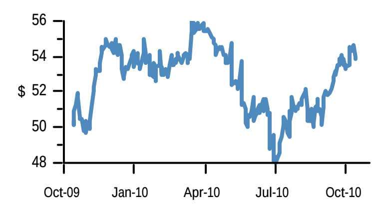
Price Performance



	YTD	1m	3m	12m
Abs	0.7%	3.1%	6.5%	6.9%

Wal-Mart Stores, Inc. (WMT;WMT US)

	2009A	2010E	2011E
EPS (Operating) ($)			
Q1 (Apr)	0.76A	0.87A	
Q2 (Jul)	0.89A	0.97A	
Q3 (Oct)	0.82A	0.91	
Q4 (Jan)	1.21A	1.24	
FY	3.65A	4.00	4.35
Bloomberg EPS FY ($)	3.61A	4.02	4.42
P/E (Operating) FY	14.7A	13.5	12.4

Source: Company data, Bloomberg, J.P. Morgan estimates. 4Q09 excludes $0.04 of charges. 'Bloomberg' above denotes Bloomberg consensus estimates.

Company Data	
Price ($)	53.82
Date Of Price	13 Oct 10
52-week Range ($)	56.27 - 47.77
Mkt Cap ($ bn)	203.49
Fiscal Year End	Jan
Shares O/S (mn)	3,781
Price Target ($)	58.00
Price Target End Date	31 Dec 11

See page 5 for analyst certification and important disclosures.

- **Take #2: Smaller Store Formats - Crawl First, Then Walk.** As many expected, Wal-Mart announced a new small store format for the U.S. that will complement its Supercenter and Neighborhood Market stores - sized less than 30,000 sq. ft. The smaller format store will help WMT penetrate both urban areas and small towns. At this juncture, the company only plans to open 30-40 small and medium format locations next year (far less than anticipated, in our view) with the majority representing Neighborhood Market formats. In total, the U.S. Segment will augment its new store growth up to 185-205 stores in 2011 (versus 153 this year) although total square footage growth (11 million sq. ft.) will be similar. In our view, a more significant small store format rollout will likely not take place until 2013-2014 time period, which is a net positive for the dollar stores, particularly Family Dollar and Dollar General.

- **Take #3: International Growth Trajectory Continues to Look Solid.** According to Wal-Mart International Chief Doug McMillan, the company continues to be pleased with the momentum and performance of its International business segment. With respect to growth, WMT is committed to international expansion and has plans to add ~23-24 million sq. ft. of retail space in FY11. With that said however, management is focused on a “thoughtful" approach to acquisitions and is keeping a primary focus on Japan, Brazil, Argentina, and China. With respect to a few specific international regional highlights: (1) Latin America - meaningful opportunity exists within the rapidly growing middle class in the existing markets of Brazil and Mexico; (2) Asia - sales in China have rebounded in 3Q - once again outpacing the market with trends in Japan also turning the corner in June and comping positive since then (including a 4.7% gain in September), compared to negative retail sales in the marketplace; (3) South Africa - Massmart acquisition remains in early due diligence/regulatory phase. However, Mr. McMillan commented that they are attracted to the company's talented management team, general merchandise expertise, multi-format capability, and rapidly growing foreign direct investment and retail spending trends in sub-Saharan Africa.

- **Take #4: Wal-Mart U.S - Expect Recovery in SSS by 4Q.** In an effort to address market share loss (some slippage among lower core customers) and soft sales trends (economy, self-inflicted mistakes), Wal-Mart outlined a series of operational/merchandising changes aimed at re-gaining lost shopper and driving better comps. While management deferred on an opportunity to speak to current trends (which means they haven't improved, in our view) they were adamant that sales would recover by 4Q. Fueling their optimism (along with an easier compare) were 3 key factors, including: (1) SKU Add Backs - increasing the assortments in all categories, with an initial focus in lower cycle time areas (dry grocery/consumables - 25% increase in some cases) with dairy/frozen/deli/hardlines/H+W and eventually home/apparel to follow; (2) Improved Modulars - re-assorting products by classification (i.e. product type, not brand (had previously put all Great Value in one section, for example); and (3) Space Improvements - expanding/contracting sq. ft. and presentation where it makes sense. Separately, we obtained the sense that the company is shifting back to a greater focus on national brands after it flirted with a massive rollout of Great Value a year ago. We think this is a smart move as the company was already late to the private label game and is known as a 'house of brands' at very low prices. Finally, the company addressed its miscues in apparel and is hoping to get back to a greater focus on basics (socks/underwear/jeans). Given the longer cycle times (say 9-12 months) in this category, an improvement here could take time, but the approach seems like the right one.

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- **Take #5: Food Pricing Still Deflationary . . . But Expecting Some Changes in 2011.** At this juncture, Wal-Mart has not experienced significant inflation in perishables (which contrasts with recent comments from Kroger) with all categories more/less flat, on average (some up/some down). Moreover, most vendors continue to be promotional - keeping downward pressure on grocery prices. In total, the food environment has remained deflationary over the last 12 months – trending down about 1.0%. Going forward, while there is some upward movement in commodity prices management doesn't expect much higher retails in the foreseeable future. Said differently, with volumes difficult, Wal-Mart doesn't see the consumer accepting much higher prices, so something will eventually have to give - stay tuned. All told, management stated it expects to see some inflation next year.

- **Take #6: Capital Spending Strategy.** For 2011, Wal-Mart expects total company Cap-Ex spend of $13.5-$14.5 billion – 3.7% above the revised FY10 spend of $13.0-$14.0 billion (at the mid-point) and in-line with total company sq. footage growth. Overall, the company believes this capital strategy accounts for both growth and improvement in ROI. In the U.S., for 2011, management guided to $7.5-$8.0 billion – which is flattish vs. the prior year. Importantly, we note that U.S. spend is expected to be helped by lower remodel costs (2011<2010, 2012<2011) and should not be meaningfully impacted by urban/small format expansion initiatives. On International, we highlight that Wal-Mart has slotted up to $4B in Cap-Ex for International as a whole – 58% of which is directed towards emerging markets (China, Brazil, and Mexico). Lastly, for Sam's Club the focus continues to be on remodeling clubs in order to improve the member experience.

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Valuation, Rating and Price Target Analysis

We rate Wal-Mart Overweight and are establishing a December 2011 price target of $58.00. Our $58 target is predicated on a weighted, blended (50% each) P/E and EV/EBITDA multiple build. The combination of our expectation of EPS growth in the mid- to high-single-digits range driven by steady low-single-digit comps, increased labor productivity, lower shrink, and solid inventory management, as well as a strong balance sheet, and improved merchandise offering and presentation leads us to believe the stock's current valuation is attractive. Along these lines, shares are currently trading at 12.4x our 2011E EPS, a 12.1% discount to its five-year historical multiple, and 6.7x 2011E EV/EBITDA. Our base-case scenario is based on 14.0x absolute P/E multiple and a 7.0x EV/EBITDA multiple. Our worst-case scenario incorporates an 11.5x absolute P/E multiple and a 5.5x EV/EBITA multiple. Conversely, our best-case scenario is based on 16.5x P/E multiple and 8.5x EV/EBITDA. The PE and EV/EBITDA multiples are 1 turn and a half turn, respectively, lower than our multiples used for the Dec 2010 price target (also $58) as slower top-line growth and an increased appetite for acquisitions will likely keep Wal-Mart from returning to historical trading multiples.

Risks to our Overweight rating exist, including the company's core consumer subject to rising unemployment, volatility in gas prices, and lower credit limits. In addition, headwinds to the top line include fierce competition from dollar stores, a successful P-Fresh rollout at Target, competitive pricing at traditional grocers, and further store disruption from remodels and SKU rationalization actions. The company's P&L could be negatively impacted by weaker membership growth at Sam's Club, deleverage of expenses in the International segment, and weaker U.S. merchandise margins through inventory restocking, sharp rollback pricing, and unfavorable mix.

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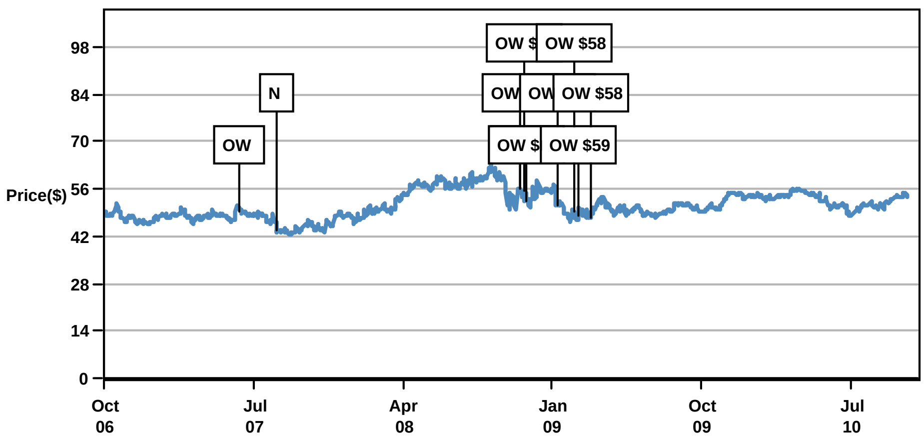
Wal-Mart Stores, Inc. (WMT) Price Chart



Date	Rating	Share Price ($)	Price Target ($)
04-Jun-07	OW	49.47	--
14-Aug-07	N	43.82	--
31-Oct-08	N	55.81	56.00
03-Nov-08	OW	55.81	65.00
10-Nov-08	OW	55.18	64.00
13-Nov-08	OW	52.62	62.00
08-Jan-09	OW	51.38	59.00
09-Feb-09	OW	49.28	58.00
18-Feb-09	OW	48.24	59.00
10-Mar-09	OW	47.51	58.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
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