

## Wal-Mart's new CEO Duke needs to build on momentum

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By Nicole Maestri - Analysis

NEW YORK (Reuters) - When Mike Duke takes over as Wal-Mart Stores Inc's CEO on Sunday, investors want to see him build on predecessor Lee Scott's turnaround plan, while proving the discount retailer can thrive when consumers are no longer desperate to save cash.

Wal-Mart's (WMT.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) stock had a banner year in 2008, rising despite broader market declines as investors bet the world's largest retailer was one of the best poised companies to ride out the U.S. economic slowdown.

Analysts and investors praised Scott, who retires this weekend, for getting a turnaround in place before the downturn, positioning Wal-Mart to gain customers as the U.S. economy weakened.

But rivals are now stepping up competition, the [food](#) inflation that drove much of Wal-Mart's grocery sales in 2008 has moderated and consumers showed this holiday season they were willing to shop elsewhere when prices were [low](#) enough.

Duke needs to ensure Wal-Mart can keep customers when the economy improves, including shoppers who crossed the threshold for the first time during the recession.

"They've gained a lot of shoppers that don't traditionally shop at Wal-Mart," said Walter Todd, principal at Greenwood Capital Associates, which owns Wal-Mart shares. "Their challenge is to try to keep those customers, or keep a certain percentage of them, as things start to improve."

Duke may also have to contend with investors eventually trading out of its stock and turning to more discretionary names, such as Target Corp (TGT.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)), whose shares are beaten down.

*"If the economy stays relatively weak, Wal-Mart should continue to outperform," said Wayne Titcher, chief investment officer of AMBS Investment Counsel and manager of the AHA Diversified Equity Fund, which also holds shares in the company.*

*"If you believe the economy is going to be roaring back, then investors are going to start taking more risk and Wal-Mart will probably underperform."*

OUT ON HIGH NOTE

Scott, who has served as CEO since January of 2000, ends his tenure on a high note. Wal-Mart is gaining market share as a fortuitous decision to slow U.S. store expansion and return to an emphasis on low prices coincided with a recession that sent shoppers hunting for discounts on necessities such as food and medicine.

Wal-Mart's sales at U.S. stores open at least a year, or same-store sales, outpaced most of its competitors in the past year. Traffic in its U.S. stores rose in October, November and December during the crucial year-end holiday season.

Its stock rose 18 percent last year, making Wal-Mart and fast food chain McDonald's Corp (MCD.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) the only two components in the Dow Jones Industrial Average .DJI to see a rise in 2008.

But in a shock to investors, Wal-Mart said earlier this month its December same-store sales rose a less-than-expected 1.7 percent. Its shares fell 7.5 percent.

Analysts said the results showed that, when prices drop low enough, as they did this Christmas holiday, shoppers still prefer to buy discretionary items that carry higher profit margins, such as clothes, at competitors' stores.

Credit Suisse downgraded shares of Wal-Mart to "neutral" from "outperform" on January 21, citing slowing momentum in the discounter's business.

"The incremental benefit it realized from consumer trade down in 2008 might not repeat itself in 2009," wrote Credit Suisse analyst Michael Exstein. "In addition ... Target is focusing on reducing prices to gain market share, which we believe presents an added competitive threat to Wal-Mart."

#### WINNING LOYALTY AS MOMENTUM WANES

Wal-Mart may also be losing a key sales driver -- food inflation. Wal-Mart is the largest U.S. grocery retailer and last year, surging prices on everything from cheese to bread translated into higher sales figures at its stores.

The food inflation also helped lure more shoppers in search of cheaper groceries. But that trend may wane this year as commodity prices decline and food inflation cools.

To keep its momentum, investors said Duke needs to build loyalty among its newest customers.

Greenwood Capital's Todd said Wal-Mart can do that by renovating its locations to appeal to higher-income shoppers used to the wider aisles and cleaner stores of competitors, such as Target.

Todd intends to keep his Wal-Mart holdings, believing the discounter will be a beneficiary of the retrenchment currently taking place in the retail sector.

***AMBS Investment's Titcher said Wal-Mart's stock has offered investors predictability amid an uncertain environment.***

***"But when you get the sense that the economy is going to turnaround, the predictability becomes less important and you're going to make more money in a higher risk names," he added.***

(Reporting by Nicole Maestri; Editing by Michele Gershberg and Andre Grenon)

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*AMBS Investment Counsel, LLC is a sub adviser for the AHA Diversified Equity Fund. Weights as of 12/31/08 were: Wal-Mart (1.51%); Target Corp (0.08%) and McDonald's Corp. (0.22%).*

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