

1Q FY20 Earnings Call with Media

Randy Hargrove

Good morning everyone. Thanks for joining us to discuss our Q1 earnings results. Brett Biggs will again be leading our call to discuss the company's business results. He's being joined by Greg Foran, Walmart US President and CEO, and Marc Lore, President and CEO of Walmart eCommerce U.S. We have a number of you on the line today with us. We will have 30 minutes for the call. As we have done, there'll be some brief comments from Brett, Greg and Marc, and then we'll try to spend the rest of the time answering your questions. Please try to limit those questions to one or two so we can get to as many as possible in our allotted time. If you need to fact check anything afterwards, you can please feel free to reach out to me and I'll try to help you. And with that I'll turn the call over to Brett.

Brett Biggs

Great, thank you. Good morning everybody.

We're really pleased with our first quarter results. Operating income and EPS were better than expected. Sales in the US were very solid. We're seeing strong comp sales and market share gains and in particular Walmart US had a really strong first quarter. We have a strong foundation in place with our stores and we have a large eCommerce business, so we have the resources and the capabilities to continue to provide really unique omni-solutions for our customers.

So a few highlights for the quarter. Total revenue is up \$2.5 billion to \$125.8 billion constant currency, a \$3.1 billion increase from last year. And currency had a negative impact of approximately \$1.9 billion. Our adjusted EPS of \$1.13 is ahead of what we expected. Greg and Marc will get into the results a little later, but the results are strong. Operating performance, as I mentioned in the US and eCommerce. A little less pressure from transportation costs and better merchandise mix in both the stores and eCommerce.

Operating income declined 3% on a constant currency basis, but was ahead of expectations because of the performance I mentioned earlier. We leveraged SG&A expenses of about 14 basis points, really strong Walmart US sales and good store productivity, but leverage in every part of the business. You'll hear, again as I said, you'll hear from Greg in a minute but we had a really strong quarter. Comp sales up 3.4%, the 19th consecutive quarter of comp sales growth. And strong US eCommerce growth of 37%. Online grocery remains meaningful, but a good quarter overall.

Led by Mexico, international comps were positive in seven of our ten markets. Total sales increased 1.2% in constant currency. And you'll recall that Easter is in a flip for international because we report on a one month lag so that would impact sales a bit in the quarter. Solid Sam's Club comp sales of 3.0%, excluding fuel and tobacco and eCommerce sales growth of 28%.

In regards to tariffs, we continue to monitor the situation. Our goal is always to be the low price leader and we'll continue to actively manage pricing and margins with our customers and shareholders in mind. Greg will briefly mention how our merchant teams are approaching this. We're going to continue to do everything we can to keep prices low, that's who we are. However, increased tariffs will lead to increased prices we believe for our customers. So overall,

we're really pleased with the results. It puts us in a good position to achieve our full-year goals. Our underlying business is really strong and the omni strategy is working. And it's been our practice that we will update certain full year guidance with our Q2 release. And with that I will turn it over to Greg Foran.

Greg Foran

Thank you, Brett. Good morning everyone.

We're pleased with the results for this quarter and encouraged by customers' response to our integrated omni-channel offering. Comp sales increased 3.4%, that's the strongest first quarter comp in nine years and the fourth consecutive quarter with growth above 3%. Operating income grew 5.5%. The strong sales and disciplined focus on expenses led to the 9th quarter of leverage. I'm encouraged by this progress, but there's more opportunity to drive the productivity loop further.

Walmart U.S gross margin rate was better than expected, due primarily to better merchandise mix including strength in private brands, less pressure from transportation costs, and improved margins in eCommerce, partially offset by continued price investments. Grocery, health and wellness, and general merchandise categories performed well. Our Easter sales were strong and we're pleased with the market share gains in key categories in Q1. Total inventory increased 5.9%, which is higher than the recent past. This is due in part to some accelerated buying in certain categories, timing of sales for summer seasonal merchandise such as outdoor patio items due to cooler weather, and increased mirroring of inventory in our eCommerce fulfillment centers which has been a priority. We expect quantities to normalize as the year progresses.

Brett mentioned that we are continuing to monitor the situation with tariffs and our merchant teams continue to work to develop appropriate mitigation strategies. We continue to be customer centric and we will win with our customers. We will maintain price leadership in the marketplace and merchants are managing costs and retails on an item-by-item basis. We are working closely with domestic and international suppliers to drive higher efficiency and reduce costs, and of course, our diverse product assortment at stores allows us to manage mix across the business. We're a large global sourcing organization so we continuously look for best costs around the world.

We continue to make the shopping experience fast and easy. And we now have more than 2,400 grocery pickup locations, nearly 1,000 grocery delivery locations offering same-day grocery delivery and of course pickup towers in more than 900 of our locations. We're on track to offer same-day grocery delivery from 1,600 stores this year, while also offering grocery pickup from 3,100 stores by year-end. That covers about 50% and 80% of the population, respectively.

Our strategy to elevate the omni-channel offering is resonating with our customers. We're pleased with the quarter but recognize there's more we can do. And we're going to accelerate innovation and refine our operations to be even more efficient as we transform the customers' shopping experience. Now, I'll turn the call over to Marc for more on eCommerce.

Marc Lore

Thanks, Greg. And good morning everyone.

We had a solid quarter growing US eCommerce sales by 37%, while adding many new great customer offerings. As Brett mentioned we also made great progress toward improving contributed profits. Behind all this is a solid execution against our strategy. We're making nice drives in nailing the fundamentals. We've seen meaningful increases in the two main scores we use to measure our progress. First is CVI, or Customer Value Index, which measures how we're doing on our five key metrics Have It, Find It, Display It, Price It, Deliver It. Second is Net Promoter Score, which measures how likely a customer is to refer someone to Walmart. We delivered a lot of new options to customers in a quarter. Earlier this week we announced free next day delivery. It's already live in multiple locations with plans to reach 75% of the population, including 40-50 largest metro markets by the end of the year, and there's no membership fee. We've been working for quite a while to prepare a phone network and mirroring inventory to make next day delivery possible in a really efficient way. We also saw our highest sales growth in our home and fashion businesses, two categories that are important to customers but also have the highest contributed profit margins, and by driving better margin mix. Just in the quarter we launched a new line of jeans with Sofia Vergara, a new home line called Flower with Drew Barrymore, a private furniture brand called MoDRN, a power box delivery service called Two Box, a new baby line with Kristen Bell and Dax Shepard called Hello Bello. We also launched a completely new and upgraded baby registry experience, which has seen great early adoption and last week we began offering pet prescriptions online and opened new pet clinics in stores, as well as adding many new pet brands at Walmart.com.

The second part of our strategy is playing offense by leveraging our unique assets. While next day delivery is a step change in the fundamentals, we need to use our stores do things only Walmart can do. You heard Greg mention the great progress we've made in grocery pick-up and delivery. Same day delivery out of our Supercenters, combined with next day delivery from our fulfillment centers, offers customers powerful ways to make fast and convenient shopping choices.

The third leg of the strategy is innovating for the future. We announced the intelligent retail lab on Long Island which offers a glimpse of how AI can help empower associates and enhance the shopping experience. From improving on-shelf availability and spill detection to ensuring freshness of produce. Finally, we re-launched Walmart Media Groups to suppliers for a more integrated way to reach customers and measure the effectiveness of their efforts across from our sites, absent stores in the US. This is where we have a deep quality advantage. We acquired Polymorph Labs which offers a platform that simplifies the process of placing ads with suppliers, serves ads faster in a really efficient way.

In summary, I'm happy how we're enhancing the customer experience and how that's driving results of the business. We're still targeting 35% growth of the year and we'll continue to focus on profit while driving that growth.

Thank you.

Randy Hargrove

Thanks Marc. And with that, we would like to now open the call to questions.

QUESTIONS & ANSWERS SESSION

Anne D’Innocenzio, Associated Press: Hi, thanks for having this call. Can you give us a little more color on the impact of the trade war? How much do you think prices could increase and how resilient do you think shoppers will be in terms of price increases? Maybe they’d be more resilient in some categories more than others? If you could give us some more color. Thank you.

- **Brett Biggs:** When you start talking about something like tariffs, everything is really fact-specific. It’s very specific to individual items and categories, so it’s challenging, if not impossible, to make broad statements about tariffs. As I said earlier, certainly tariffs tend to lead to increased prices. We’re the low-price leader, that’s our DNA, we’re going to do what we can, but we’ll be balanced about it as we think about customers and shareholders. It’s a tough one to talk about in broad generalities.

Amanda Lasky, CNBC: Hi, my question is for Marc. I know that you guys launched the next day shipping this week and it’s being tested in Phoenix and Las Vegas. I just wanted to see if you had any initial response from the cities that are in this testing area and if you have seen an increase in orders?

- **Marc Lore:** It’s still only been a day so far, but we’re happy, we launched on time and we feel really good about the customer experience and look forward to seeing the results in the following days.

Amanda Lasky, CNBC: Can I ask a follow-up? If possible, would you be able to give us an update on JetBlack. It’s been almost a year since you guys have been testing and launching it in New York City – do you have plans on launching JetBlack in other cities in the future?

- **Marc Lore:** We’ll continue to stay focused on New York City right now, we have quite a large waitlist of people wanting to use the service. So, we’re still in that early stage of building out the technology and capabilities for more customers.

Sarah Halzack, Bloomberg: Good Morning. Thanks for doing the call. I have two questions, one for Brett and one for Marc. So for Brett, could you tell us what in terms of tariffs is and isn’t contemplated in the current guidance? I’m assuming that the batch of tariffs that just went for 10 to 25% is contemplated in the guidance and the more recent proposed tariffs on \$300B worth of goods that includes clothes and jewelry and stuff is not, because that’s more recent, but if you could provide some clarity on that, that would be great. Then my question for Marc is for a little more detail on home and fashion. I think that was the first time I’ve seen that call out at the top of the press release that’s contributing strongly to eCommerce growth, and I know you called out some of the new initiatives in the space, but are there any particular brands that are driving that growth, are there any particular subcategories, like Womens vs. Kids, or soft home vs. big cube, just any more detail you can give on what’s going on in home and fashion would be great.

- **Brett Biggs:** I’ll start. We give our annual full-year guidance to start the year and we don’t typically update that until the second quarter, so we’re not done updating the guidance and as I said, and as Greg also mentioned as well, our merchants have been working on mitigation plans, they’re going to work with our suppliers, they’re going to do what’s right for customers and shareholders in mind is how they’re going to manage

prices though this. Again, there's no way to talk about tariffs in generalities, but we update guidance at the end of the second quarter.

- **Marc Lore:** To answer your question about home and fashion – home and fashion were the two highest contributed profit margin categories as part of our goal this year to drive margin mix into those categories, and we're seeing the benefits of that strategic approach. Home and fashion are growing considerably faster than the rest of the business, so that's really helped drive contributed profit in the quarter.

Brian Sozzi, Yahoo Finance: Hey guys, top of the morning. Marc, for you...two, how sizable from a cost perspective is it to roll out next day free shipping and continue to make the same-day online grocery push? And also, any plans to expand the autonomous pilot with Waymo?

- **Marc Lore:** With regard to next day, the way we structured it is, not only it's great for the customers, but also for the bottom line, so we've basically locked down the assortment in a particular warehouse that's within proximity of a customer – via one day ground, which allows us to get all the products via ground next day in one box, which avoids split shipping – shipping in multiple packages, which we're doing quite a bit of with two day shipping – so we do expect to see quite an improvement in shipping rates. It should be positive. Waymo? I don't know, Greg?
- **Greg Foran:** Look, we're in the very early days – we're just testing and learning as we go there. As more information comes to light, we'll share it. We want to see what we can learn in this autonomous vehicle delivery space, and that's exactly what we're doing.

Matthew Boyle, Bloomberg News: Thanks for taking my question. This is for Greg, you called out private brands as fueling the US Comp this quarter, particularly in food. Why are private brands doing better for you and what's your strategy to gain even more share and margin without jeopardizing the relationship with national brands?

- **Greg Foran:** Thanks, Matt. Private brands are doing better with us primarily because we've improved the quality and also, we've taken action on price where we've needed to, so the combination of those two things sees a more appealing package to customer and we sell more units. In terms of how we think about them, we've got the benefit of having large stores, these stores are 4 acres, so we're not pressured to have to make choices around...we're not going to sell this particular brand, so we put items on the shelf and let the customer make the selection – that's what's driving it. We've got plenty of areas where our growth with national brands, that's also very impressive. So that's what's driving it.

Sarah Nassauer, WSJ: Morning everyone. I'm hoping... two questions, one is, can you guys speak to what you're seeing with the consumer right now? Again, there's a little bit of up and down data points when we look at retail sales and things like that – your sales seem to reflect a really strong and robust consumer behavior, but can you speak to what you're seeing more specifically? And second, Greg, I've seen this called out in some of the commentary today, there's a lot of change going on in stores and I'm wondering how you're seeing that, what associates and maybe store manager are telling you about that, and what you're doing to help front-line workers and store managers manage during a time of a lot of change?

- **Greg Foran:** In terms of the consumer, Sarah, we've characterized the consumer being in pretty good shape at the moment, based on what we're seeing. Unemployment is

pretty low and we think they feel that they feel good about their personal finances and gas prices are reasonably low, though we've seen some recent increases, at the end of business last year is comparable. So, we think the consumer, our customers, are in pretty good shape. With regards to changes in stores, if the rate of change hasn't slowed down in stores over the last five years, and if you reflect on things we've introduced from, first of all, putting up things like top stock and cap process and changing some of the technology and giving our associates things like T-70 to help them with section work. Now of course, we're into robots going up and down the stores and automatic cleaning carts, and various things. Ya know, that rate of change continues to probably increase. So what do we do about that? A number of things, we've obviously have rolled out academies, so we have just over 200 of those around the country; we've introduced virtual reality training in stores, so on average a store has an average of 5 virtual reality headsets. So, for example, some training that we rolled out a couple of weeks ago to all our cashiers that was done on virtual reality and that was to ...out check-out processes. We continue to have regular cadence of meetings with our shareholders or YBM holiday meetings, so there's a whole cadence of things to go in to ensure that we bring people along what is a changing journey because the customer is changing. When you introduce 1,000 more online grocery stores, you're now introducing in 1,000 stores personal shoppers. So lots of things happening and it's exciting. I'm really pleased with the way that our associates embrace it, our leadership embraces it. Doesn't mean sometimes we don't get the communication quite right, but by and large my sense is that we've been doing the right thing and the right cadence for our customers.

Lauren Thomas, CNBC: Awesome, thanks so much for taking the time. Two questions, and they're both for Marc. First thing I wanted to ask - any update on your strategy to acquire these digitally native vertical brands? Obviously, you've done a sting of those recently and wanted to know how that's going and how you continue to think about that? And the second is any update you can give on these tie-ups, like with Lord & Taylor and I know you did Fanatics online - any...how those partnerships are going and what you're seeing to reaction online? Thanks.

- **Marc Foran:** Okay, great. Regarding the digitally native vertical brand strategy, so the strategy is morphing, as we've sort of learned, and we've seen a lot of success with creating brands that are omni – that cut across both direct-to-consumer, Walmart.com, and stores – so we're putting more emphasis on brands that can cut across all three channels. So, that's some of what we've learned, but stagey hasn't changed we see the NVBs with more than strategy, it certainly helps with margin mix – you come in at much higher contributed profit margin than any other product we sell. Regarding partnerships with Lord & Taylor, Advanced Auto Parts, Fanatics – those are the three we've done – we've also just done a partnership with online pet RX – so that's another partnership we've done lately. And we continue to look for new partnerships in some of those long-tail categories to help accelerate entries into both of those categories, again to help drive margins.

Nandita Bose, Reuters: Thanks for taking my question. One around tariffs – you're obviously saying that a rise in tariffs means a rise in prices for consumers. Can you talk about how soon you're expected to take some of those price increases and for how long you're covered with inventory that hasn't been impacted by the 25% tariff?

- **Brett:** We keep coming back to what I said earlier, which is, it's very fact specific, it depends on product and category. There's just no general answer to that question. From a competitive standpoint, we're just not going to talk about it item-by-item and category-by-category.

Nathaniel Meyers, CNN: Hi guys. Can you talk a little bit about the impact that Aldi and discount grocers are having on the price environment right now and some of the investments you guys are making in price?

- **Greg:** I'll take that one. I think the competitive environment out there is much the same as I've seen over the last few years. The discount is a very weirdly competitive piece – it keeps us extremely honest and intense about price position. There was the activity, I guess about 18 months ago when Lido started opening stores, and we've seen some more recent activity from them recently, Aldi continued to get out and remodel, we know how active Dollar Stores are in terms of opening, so each of those players are very, very price competitive and we track them closely. It's clearly very important to our DNA to maintain low prices, so we're active all the time in the marketplace to ensure that our customers get the lowest price possible.

Julia La Roche, Yahoo Finance: Hi everyone, thanks for taking my question. Most of mine were asked at this point, but I am curious about inventory. I noticed you all said it increased by 5.9%, which is higher than the recent past. What are some of the drivers of that and does it have to do with mitigating any possible tariffs?

- **Greg:** The simple answer is that there are a series of things that drove inventory. One of them is, as Marc and I have both mentioned, we've done some mirroring in our ECs to ensure that we are in a good position for next stage. So that's been a component of it. Another part of it is that we've taken the opportunity to build up a bit of inventory to capitalize on some market opportunities, so, toys, shoes are two departments where we've encouraged our merchants to get out there and take some opportunities and that's obviously in response to Toys R Us and Payless Shoes. And we're also a little bit heavier in general merchandise as we look to drive some extra sales in a few seasonal categories, things like outdoor patio items. And they're really the three components that have driven inventory and as I mentioned I'm comfortable with the position that we're in and think we're in good shape.