Company Name: Walmart
Company Ticker: WMT US
Date: 2017-02-21
Event Description: Q4 2017 Earnings Call - Follow-Up

Market Cap: 293,941.76
Current PX: 102.43
YTD Change($): +9.28
YTD Change(%): +9.962

Bloomberg Estimates - EPS
Current Quarter: 1.021
Current Year: 4.763
Bloomberg Estimates - Sales
Current Quarter: 124955.000
Current Year: 529637.417

Q4 2017 Earnings Call - Follow-Up

Company Participants

- Steven P. Schmitt
- Kary Brunner
- Pauline Mohler

Other Participants

- Oliver Chen
- Joshua M. Siber
- Karen Short
- Mike D. Otway
- Matthew J. Fassler
- Beryl Bugatch
- Greg Melich
- Michael Lehrhoff
- Robert Drbul
- Daniel Thomas Binder
- Tiffany Kanaga
- Robert F. Ohmes
- Michael Louis Lasser
- John Zolidis
- Zachary Fadem

MANAGEMENT DISCUSSION SECTION

Steven P. Schmitt

Highlights

Adjusted EPS and Sales Growth

- I hope you've seen our earnings materials from early this morning
- I'm not going to repeat everything that's in those materials, but I will touch on a few of the highlights
- Adjusted EPS was $1.30 for Q4 and we really had a solid close to the year
- Nice top line growth really across the company
- I would point out we've had a 1.2% comp growth in the United States with a 1.4% increase in traffic and US GMV growth of 36% and I'm going to talk about that here in just a bit
- We're making progress to win with customers through our stores, through mobile and e-commerce

Operating Cash Flow, Dividends and Share Repurchase

- Our financial strength continues to be a great competitive advantage for us
- We generated $31.5B of operating cash flow in the year, demonstrating consistent strength in the business and continued strength in the business
- We returned over $14.5B in the form of dividends and share repurchases for the year while at the same time investing to grow the business
  - You may have seen also today that we raised our dividend for the 44th consecutive year from $2 per share to $2.04 per share on an annual basis

GMV and E-Commerce

- Now let me talk about – a little bit about GMV and e-commerce
- You may have noticed in the materials this morning that we are going to be reporting e-commerce a bit differently going forward
- We've typically reported a global GMV and sales number and we've given you that number in our remarks
  - And if you haven't seen it, our global GMV number increased 29.7% in Q4 ex Yihaodian and that compares to about – that compares to 28.6% that we reported in Q3

Web-Initiated Transactions

- I want to just touch on that going forward we're going to be focusing more on the US e-commerce business which is led by Mark Lore
- This includes all web-initiated transactions including those through walmart.com such as ship to home, ship to store, pickup today and online grocery and transactions through Jet.com
  - We hope you find this new way of reporting e-commerce helpful as you dig into our largest e-commerce business
  - So those are my opening comments

QUESTION AND ANSWER SECTION

<Q - Oliver Chen>: We had a modeling question. As we think about inventory, it's been impressive. Going forward, would you expect us to continue to underpay comps and sales and what is your assumption as well for the outlook for wages and wage growth? And just a follow-up. A question we are receiving a lot from clients is regarding the regulatory and geopolitical landscape. Do you have flexibility in your supply chain to think about changes in the context of potential tariff issues? Thanks.

<A - Steven P. Schmitt>: I hope you didn't drop off. I actually missed the first part of your question. We didn't have a great – did you get it Kary?

<A - Kary Brunner>: I think he was talking about wage growth and kind of our outlook for that. As you know, we're lapping our large wage investment, our multi-year wage investment here in February. And so, that will now be in our base. As we think about wages and being competitive – we're always looking to be competitive in the market to get the associates that we need to serve our customers, but we don't expect a large increase this year like we've had in the previous two years.

<A - Steven P. Schmitt>: And then, Oliver, I didn't get the last part of your question. I know you were talking about supply chain in general I think.

<Q - Oliver Chen>: The geopolitical and the regulatory landscape in terms of supply chain flexibility, if indeed there is a border adjustment tax. It's just a topic that clients in the buy side have been asking us about regarding – there is a lot of different possibilities, but I was curious if there was a framework we should think about?

<A - Steven P. Schmitt>: It's certainly been a topic of interest. Certainly in the news, it's on constantly. So we certainly have robust supply chain for sure and anything – one thing I've learned in my experience is, anything related to tax is complicated and this is no different.

In terms of what we're talking about is, we're aware. Obviously we're engaged, but in terms of trying to speculate on what that might mean, it's just too early for us to do at this point. So I certainly appreciate the question. We are aware and we're engaged. Thanks.

<Q - Oliver Chen>: And just lastly on the inventory, inventories was really great this quarter. Do you expect it to continue to decline at a rate greater than sales for this next year as we model that line?

<A - Steven P. Schmitt>: It's hard to give a prediction on where it might go, but I know the US team's made a lot of progress and they think there is more progress to go.

<Q - Joshua M. Siber>: A couple of e-commerce related questions. First, did you guys parse out the e-commerce growth between Walmart and Jet.com? And then second, does the 1.8% comp include Jet.com sales? And lastly, what percentage of your sales are e-commerce?

<A - Steven P. Schmitt>: So the first piece of it is, no we didn't break out Jet.com specifically and we've really made the judgment going forward as – as we talk about our US e-commerce business, we're going to report it in total. And it's not just Jet.com if you think about. There's other acquisitions in the space. Jet.com has a business called Hayneedle that they bought before Walmart acquired it. You may have seen in the news, we've bought a company called ShoeBuy as well as Moosejaw. So we've made the decision not to break all of those different pieces out. We'll just be reporting the US business e-commerce number in totality.

The second part of your question was, is Jet.com in the comp? And the answer is, no it's not. We wait until we anniversary any new business before it actually is included in the comp. We did note in a release that e-commerce for the US contributed 40BPS to the total comp and – and what's the last question, Kary?

<Q - Joshua M. Siber>: Yeah, percentage of sales from e-commerce total in the U.S.

<A - Steven P. Schmitt>: Oh, that's the number we've broken out in fashion.

<A - Kary Brunner>: Overall, it's…

<Q - Joshua M. Siber>: Oh, okay. Then my follow-up on related. What are you guys seeing in grocery? Where is the deflation moderating and do you guys have an outlook for potential inflation going forward?

<A - Kary Brunner>: So really, solid quarter for grocery perspective. And you're right, we had about 90BPS headwind in the food comp. The primary factors are – continue to be meat and dairy, eggs. We even saw some deflation in produce this quarter as well. So, kind of the same culprits you've heard us talk about over the last couple of quarters, but underlying traffic in grocery, particularly in food, much improved from Q3.

<A - Steven P. Schmitt>: Sorry, I think the other question that you asked about, what percent e-commerce makes up in the US. It's about 3%.

<Q - Karen Short>: Just curious. So you've been discussing the fact that we'd start seeing the components of the U.S. margin shift with more meaningful declines in gross margin but less pressure on OpEx. So I guess the question is, was the decline in Q4 gross margin kind of the new norm to think about going forward? And then I guess the follow-up would be, in the transcript Brett commented that Walmart would lever expenses slightly in 2018. So is that statement also true for the US? And then I guess, what would have been so unique about Q4 that caused such deleverage?

<A - Steven P. Schmitt>: When we're talking about margin, obviously, there's a lot of moving pieces. You mentioned the two that Brett called out, which actually mentioned one of them, which was the price investment. We continue to invest in price. We also had top post-holiday markdowns in the quarter that had some impact.

Just going back to how we addressed really operating profit in general going forward at our October meeting, we laid out that – a couple of pieces. Number one, that we expected Op Inc to go down. And, Karen, you mentioned that Brett had – that had – in his script today. But also, we would be leveraging expenses at the same time. So that would be putting pressure on gross margin. So we would expect some of that going forward. In terms of order of our magnitude, we just aren't in a position to talk about that or even – even as it relates to the U.S. business, but I think it would hold there. And that's kind of – hopefully that answers your question.

<Q - Karen Short>: And just a follow up. What's the level of food inflation or deflation that's embedded into your comp guidance or expectations?

<A - Steven P. Schmitt>: We haven't talked about that specifically. We have seen, I think as Kary mentioned a trend from deceleration [audio gap] (10:32-10:35) something we'll continue to watch and report on a quarterly basis.

<Q - Mike D. Otway>: Thanks for taking the question. First, I think in the prepared remarks you guys said that the sales have been slower to start the year. Do you have any context around that comment?

<A - Steven P. Schmitt>: I think two things. Brett had mentioned that sales were a little slower than expectations coming into the year due in part to the delayed tax checks coming in. So in light of that, we've guided to 1% to 1.5% comps in the US business.

<Q - Mike D. Otway>: And then I guess secondly on kind of Jet-specific, the dilution from Jet, how is that progressing relative to your expectations? Better or worse? In line?

<A - Steven P. Schmitt>: I think there's always going to be change. I don't have the exact numbers on where that's falling in vs. our initial expectations, but it's all included in our outlook.

<Q - Matthew J. Fassler>: My first question, guys, relates to U.S. gross margin. You spoke about pricing investment. Was that the biggest factor that led to that – the break in that series of increases that you had on the gross margin side? And I ask because I know that vendor negotiations have been a big piece of what had helped you drive that number higher I think for six quarters running. So how would you talk to the change in trend or the components of the change in trend for that line item?

<A - Steven P. Schmitt>: It's certainly no surprise that we continue to invest in price. We're not going to break out each different element on what it weighed on [audio gap] (12:34-12:35) factor as well as the post-holiday markdowns and a number of other issues. Kary, you want to mention any other issues?

<A - Kary Brunner>: I think a biggest change from Q3 was, as Steve mentioned, the post-holiday markdowns. We've pulled those forward from original plan in Q1.

<Q - Matthew J. Fassler>: And then a follow up. You Sam's Club comp ex gas picked up a bit, was a strong number. Any sense as to what's changing within that business? I know it doesn't get a lot of focus on these calls, but it did show some acceleration.

<A - Steven P. Schmitt>: Tobacco performed well, so Grocery, Beverage, Home & Apparel, Health & Wellness, all of those categories performed – continue to perform well for us. So you see that affecting the comp.

<Q - Beryl Bugatch>: There have been some confusion, a story appeared in the press about the combination of the online and the in-store buying organizations, and then I think a correction or something was – appeared I think a day or so ago. Can you kind of give us a feel of what's going on with the organization for e-commerce and merchandising organization of – in your stores?

<A - Kary Brunner>: Sure, Budd. I can take that one. We're really approaching the business to serve a customer really any way the customer wants to shop, so through our stores, through online, or through omnichannel. And we're really just positioning the business and the merchandising organization to serve customers. So, if a supplier wants to sell on store and online, he'll now have one point of contact within the merchandising organization to get that done, to accomplish that. So it really streamlines our organization.

We think it's a benefit not only for us, but also for our suppliers. That's the feedback we're getting. And this is not unlike some of the other changes we've had in other parts of the business like marketing where there is one individual sort of responsible for both stores and e-commerce marketing. So, just positioning the business to better serve customers and streamline our interactions with suppliers we think for the benefit of both.

<**Q - Beryl Bugatch**>: So, Kary, that actually confuses me, because then you have in fact combined the organization? Or is it just not? And…

<**A - Kary Brunner**>: No, it's just – if a supplier were to sell goods in a store and they wanted also sell a good online, in the past they would have talked to two different merchants, one for the store and for online. Now, in today's day – in the future state, they'll talk to one individual. If they are only selling goods online, they'll continue to just talk to an e-commerce merchant.

<**Q - Beryl Bugatch**>: So has the SKU file been combined? That was one of the issues that was preventing that, I thought.

<**A - Kary Brunner**>: I didn't get...

<**A - Pauline Mohler**>: SKU file.

<**A - Kary Brunner**>: That's something we're focused on, yeah.

<**Q - Beryl Bugatch**>: And lastly from me, on some of the new innovations in the store. You talked about Scan & Go inside of Walmart. I thought that was something that couldn't be done because of the weighing issue inside of Walmart. Is Scan & Go being deployed inside Walmart?

<**A - Steven P. Schmitt**>: It's being tested, Budd.

<**Q - Greg Melich**>: I guess I wanted to follow up a little bit more detail on the categories. I think in the general merchandise, you mentioned some strength in apparel. Like to know a little bit more about that beyond just newness. Was it, you know, mix helping there as well? And then in entertainment, you said it was soft in electronics. Does that mean like TVs and what were actually down for that category? Or is it just softer than the company?

<**A - Kary Brunner**>: I'll take that one. Yeah, so as we look at apparel, it really did have a strong fourth quarter. Now, as we talked about in Q3, there was some pent-up demand as there was some weather impacts in Q3 and so some of our benefit in Q4 was due to that. But nevertheless, overall, we just were really – really pleased with the performance there in apparel.

And then I think you mentioned entertainment. Entertainment overall was a headwind for us, and particularly in electronics. Our unit sales in TVs were still good, but just deflationary pressures that we've seen in the industry continue to be a headwind there. There are some pockets of entertainment that are doing better than others. Toys had a good quarter. We think about wireless, had a pretty good quarter, and virtual reality, some of the new items that we have are doing pretty well. And so really where there's newness and innovation, those categories are doing really well; and where there's not, there's a bit of a headwind.

<**Q - Greg Melich**>: And then I go for my – my follow-up would be, switching to your import mix and private label, understanding you're not going to go with the border adjustment or tax reform, but could you just help us understand where you are now, an estimate of how much of your COGS or sales are foreign direct imports or private label – and/or private label?

<**A - Steven P. Schmitt**>: Certainly appreciate the question given the back conversation, but we're just not going to go into that level of detail at this time.

<Q - Michael Lehrhoff>: I just wanted to clarify that Jet I guess would now fall into the comp next year in Q3 and also see how the early sales results are trending vs. your previous expectations. And if you could talk a little bit about your strategy behind some of the smaller acquisitions like Moosejaw and ShoeBuy? Thanks.

<A - Steven P. Schmitt>: Sure. So the answer to your first question is, that's correct, it would fall into the comp in I guess mid third quarter. I think the next question is just around some of the acquisitions that we've made. It really gives us more expertise – access to a lot more SKUs and brands in a short order.

Michael, anything else on the ShoeBuy and Moosejaw?

<A>: I think the industry relationships that they bring along as well are key in some of these categories and the way that we can leverage what they had to display products. The technology is good as well.

<A - Steven P. Schmitt>: And a lot of expertise in those categories as well.

<A>: Yeah.

<A - Steven P. Schmitt>: So it's all part of our investments to grow e-commerce faster strategy.

<Q - Robert Drbul>: I just wondered if you could comment a little bit more on Fresh and how it performed during Q4, and were the – days inventory, how much have you taken out of the supply chain? Maybe just a little bit from those couple of topics?

<A - Kary Brunner>: Sure, Bob, I'll take that one. Fresh is an area we've been really encouraged by. Customers are responding well, traffic is strong, but you are not seeing probably the reported results because it's been somewhat masked by the heavier levels of deflation that we've seen all year. While that seems to be abating in Q4, the underlying strength of the business is good. And we've invested in that area to add additional head count. We've changed our merchandising approach and displays. And we're trying to get the inventory and days on hand correct. There's a lot of focus on that. And we're working to take days out of the supply chain, so that's fresher for the customer when they get at home. Those are all areas of focus, and we're really pleased with the direction we're headed.

<Q - Robert Drbul>: And can you talk a little bit about what you've learned so far as the rollout in online grocery has continued?

<A - Kary Brunner>: Yeah, I think we've been pleased with the customer response to that. The promoter scores on online grocery have been exceptional. And customers are increasingly wanting that level of convenience. And clearly, it's a key part of our strategy. We've rolled out 600-plus locations currently, and we'll almost double that next year. So that's a key part of the focus. Customers like it, and we're pleased with how they're responding.

<Q - Daniel Thomas Binder>: I was thinking back to the analyst meeting, and Brett I believe said that he thought in his comments that you would have peak losses in e-commerce this year. And I was just curious, with some of the announcements since then, mainly the free shipping – free two-day shipping with $35 baskets or higher, if that changes that expectation for peak losses this year? And then secondly, I assume that that same program would probably have more of a detrimental impact on profit than the ShippingPass program, which you have eliminated. And I was just curious if there is some offsets to that?

<A - Steven P. Schmitt>: Just going back to – in terms of October, one thing we did say is that – in this part of our guidance that we were going to be making investments to accelerate e-commerce, and this is certainly [indiscernible]. In terms of out-year guidance on peak, so we typically do that on annual meetings. But this is absolutely an example of one of the investments that we've made to accelerate that growth.

In terms of margin, the impact on our recently announced $35 minimum two-day shipping – free shipping for millions of SKUs on walmart.com, certainly it could have an impact on margin, but it's part of our strategy to grow e-commerce faster to give customers more options to use our brands. And all of our assumptions around that initiative are incorporated into our outlook and our guidance.

<Q - Daniel Thomas Binder>: And if I could just – one follow-up. In terms of private label product, obviously the hard discounters are going to expand here in the U.S. We know Lidl will open stores later this year. I was just curious, with the private label development program that you started last year with the food innovation center, where you are with that in terms of upping the quality and lowering the price? And how private label performed in the quarter generally?

<A - Kary Brunner>: Yeah, Dan. It's a key area of focus, and we're growing penetration in our private label, working to get the price points correct, but also raise the quality. And certainly the Innovation Center that you mentioned is helping us on that front. Private label is one portion of the overall U.S. strategy and we expect it to help us deliver the growth that we expect.

<Q - Tiffany Kanaga>: Thanks for taking our questions. Would you discuss the puts and takes to your 2017 EPS guidance and where you see the biggest risk factors that could lead results to come in at the low end of the range as well as how your investments in Jet.com and JD.com play into the range that you've given?

<A - Steven P. Schmitt>: Good question. I think any time you're looking at a forecast, it all starts with top line. That's going to dictate the majority of it. Already – in addition to top line, I mean we've talked about getting more focused around cost. I think there's always moving pieces. I think inflation assumptions would come into it. I can't think of any specific things. We've made assumptions around e-commerce investment. Certainly FX is always a variable. Tax rate, we did talk about tax rate being a little bit higher this coming year than what we saw some of the benefits that came through last year. That's probably a good list of the puts and takes.

<Q - Robert F. Ohmes>: On the gross margin shift in trend, can you give us a sense and – or just remind us if you guys have spoken of this. But is the gross margin shift in trend, is it broader and deeper price investment this year vs. last year? Or is it e-commerce having more of an impact on the gross margin this year vs. last year? Or is it just the offsets won't be as great in FY2018 as they were in FY2017?

<A - Steven P. Schmitt>: Yeah, I think – let's talk about pricing first I guess. We initiated the price investment towards the end of our first quarter – so we continue that. So as you continue that process, it will put a little bit more pressure until you start cycling through some of that. That's the pricing piece. And I think from the other initiatives – I think that you mentioned e-commerce, those are all contributors and we have to get better on the cost management side, similar to what Brett laid out in the guidance in October and reiterated today in his script.

<Q - Robert F. Ohmes>: So incrementally though, is it – are there more initiatives hitting at the store level than you did last year? I'm just trying to get a sense of, is it a – I think you guys used the term, continues to ramp up. And maybe just a sense of, you know you've already been investing in price, but is it – are we seeing another level coming on this year and that's what you have in your gross margin guidance?

<A - Steven P. Schmitt>: We have price investment in our gross margin guidance for sure. I mean, this – it's a continuation of the program that we started last year. So I don't know how much more we can add than that.

<Q - Michael Louis Lasser>: I think Kary mentioned that traffic to the food category accelerated from Q3 to Q4. Was that all due to the price investment?

<A - Steven P. Schmitt>: No. We've had healthy traffic all year actually in Grocery, and so this is just continuation. We did see a slowdown in Q3, and then it – Q4 came out better than Q3.

<Q - Michael Louis Lasser>: Okay. And on Q1 guidance, do you assume that all of the tax rebate issues normalized over the course of the full quarter? It's – it will be neutral or will it still be a drag to your comp in Q1?

<A - Steven P. Schmitt>: I think it's difficult to say. We'll have to watch it. We've got a lot of tax refunds dropping this week, so would be an interesting week to read for sure. But there's always a lot of moving pieces in the guidance, and that's what we're comfortable with.

<Q - John Zolidis>: Questions on two different topics. First, could you explain the decision to move the post-holiday markdowns into Q4 from Q1? And could that be a contributing factor to the weaker than expected start to Q1? And then my second question is on the grocery drive-thru's. You said that you've gotten up to 600 drive-thrus. Do believe that those are accretive to same-store sales? And can you quantify, or do you have ability to measure the extent to which you might be capturing new customers to shift – or rather than just shifting in-store customers to the drive-thru's? Thanks.

<A - Steven P. Schmitt>: Sure. Maybe I'll take the second part of the question first, and maybe Kary can address the first piece. So the online grocery piece, we're expanding it at a high rate, at 600 groceries this year and we expect to nearly double that this year with the amount of new online grocery locations that we're adding. So all-in we're confident what we're seeing. Customers are giving us great feedback. In terms of exactly how incremental it is or accretive for the comp, we are not going to go into that level of detail, but I think it's safe to say, with our expansion plans we are happy with what [indiscernible] from an overall result standpoint. Kary, you want to comment on the [timing]?

<A - Kary Brunner>: Sure. Yeah. So we had a very strong fourth quarter and we saw an opportunity to kind of position our inventory and clean-up some kind of winter-related cold weather merchandise through clearances and otherwise. And so, really just – some of the markdowns that were planned for a couple weeks later were moved forward so that we could put the business in a good position going into the spring set.

<Q - Zachary Fadem>: So with respect to the online grocery and pickup. I know it's early, but are you including the sales in the e-commerce contribution or – for the comp or in the traffic bucket? And then on the traffic, just with Walmart US and Sam's Club both improving quite a bit in the quarter, I'm curious if there are any specific callouts here in terms of drivers, be it grocery or otherwise?

<A - Steven P. Schmitt>: Sure. So I think the first part of your question, the online grocery is included in the e-commerce growth as well as the comp. And then what was the question on Sam's?

<Q - Zachary Fadem>: Well, just with the traffic accelerating, just drivers there.

<A - Steven P. Schmitt>: Yeah, I mean, traffic at Sam's – the overall comp is pretty balanced between ticket and traffic. I think Tobacco has been a good traffic driver for us, but also Health & Wellness.

Steven P. Schmitt

Closing Remarks

Thanks. Again, thanks everybody for joining us

Again, just kind of the highlights

We think we had a really solid close to the year

We appreciate your interest in Walmart and your time on today's call and Investor Relations, myself and the rest of the team will be available today for follow-up

Have a great week. I know today is a busy day for you guys