Goldman Sachs Global Retailing Conference

Company Participants

- Steve Bratspies, Executive VP & Chief Merchandising Officer of Walmart U.S.

Other Participants

- Unidentified Participant, Analyst, Unknown

Presentation

Unidentified Participant

Okay. We're going to get started. We're doing this lunch a little bit differently than yesterday because this is being webcast. So we are kind of have to start on time. But we're planning to wrap this up a little bit before 1:00. So you'll have a little bit longer of a break post the Walmart presentation.

Welcome to our lunch keynote today. We are speaking with Steve Bratspies, Chief Merchandising Officer of Walmart U.S. The Walmart U.S. business just posted its strongest 2-year stock comp in 10 years when it reported Q2 results in August. Our positive thesis on Walmart is based on its ability to leverage its store base for e-commerce while growing traffic at the stores and improving profitability. Walmart also guided U.S. comps towards the upper end of its prior range of 2.5% to 3% with positive expense leverage.

We think Walmart's strength is coming not only from the ease and convenience of its delivery and pickup options. But also from its strong merchandising, as the company continues to improve its offering to customers, both in-store and online. Focusing on how Walmart has changed and improved its merchandising in the U.S. will be a focus of our conversation today.

To introduce our speaker, Steve has held a variety of merchandising roles, most recently overseeing Walmart's food business, including responsibility for private brands and global food sourcing. He also has held merchandising roles responsible for dry grocery and general merchandise businesses. He joined the company in 2005 and was promoted to Senior Vice President of Marketing in 2007.

I'm going to turn the floor over to Steve for a minute. And then we will sit with our fireside chat.

Steve Bratspies {BIO 18295554 <GO>}

Thank you. And thanks for having us. We appreciate it. Thanks, everybody, for joining. Just before we start, I ought to do our normal disclaimer around we may be making some forward-looking statements. So I encourage everybody to please refer to our safe harbor statement that's available on our corporate website. Thank you.

Questions And Answers

Q - Unidentified Participant

Okay. I think where I wanted to start out just because it's been so exciting and it's been such an exciting part of your story is the rollout of grocery pickup, which has been available now at -- is 2,700 doors?

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. It will be 3,100 by the end of the year.

Q - Unidentified Participant

Okay. So I wondered if you could talk about what you've learned from this initiative and why do you think it's bringing new customers into Walmart that might have been shopping for their groceries elsewhere?

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. Online Grocery pickup, or click-and-collect, as some people refer to it, has been a really big success. And it's one of the reasons we're rolling it out as fast as we possibly can. So as I said, we will hit 3,100 stores by the end of this year and -- it continues to gain momentum. It's proving to be highly incremental to our business and bringing in new customers and with strong repeat.

Now the average basket size is about 2x what a standard grocery basket is. So obviously we're excited about that. NPS is a measure that we use broadly across the company. But the NPS score on Online Grocery is over 80. So it's really strong. And we're starting to see a little bit difference in mix. This customer, (we could) sell a lot of organics and a lot of healthier products through Online Grocery, which has been an interesting dynamic for us. And it's forced us to merchandise a little bit differently. As we pick throughout our stores, different times of the day, we got to make sure our in-stock is at peaks at different times of the day. So it's working its way through the entire infrastructure as a company and continues to prove to be a pretty good growth vehicle for us.

Q - Unidentified Participant

Okay. Great. And it sounds like you plan to start testing InHome Delivery of groceries later this fall. Just if you can maybe walk us through how that will work, what you're testing, what you're looking for and what we can expect from that.

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. InHome Delivery, it's an interesting concept and one that -- and as I look around the room, I see different smiles and looks on people's faces because it's -- for some people, it's a real stretch to say I'm going to let somebody inside my house to go do this. But we've been testing it for a while. And we've had really good response. The people who want to do it really love it. And there are some customers where it's just not for them, which is fine.

But we'll be rolling out at the end of this year into Pittsburgh, Vero Beach, Florida and Kansas City. So big markets. There will be about 1 million customers who'll have access to it by the end of the year. And it literally allows us to replenish customers. And they don't have to be home when we do it. And it enables also some real cost efficiencies for us from a delivery perspective because we have more flexibility on when we deliver. So I don't have to schedule an appointment with you to be at your house at a certain time. That allows a lot of labor scheduling and smoothing over time. So we're pretty excited about all the different paths we have to serve customers.

We talk about Online Grocery. Now we're talking about InHome Delivery. There's also scheduled delivery. If you wanted to ship us directly to your house, we're going to have NextDay delivery. So we're really working to build an ecosystem and several different delivery methods that allow us to serve all customers.

And as a company, as we continue to grow, our focus is how do we become, we call, channel agnostic. We just want customers to choose Walmart. And whether you want to come to shop the store normally, you want to pick it up at the curb or we bring it to your house, we'll do it however you want. But we just want to capture as many customers as we can and serve them as broadly as we can.

Q - Unidentified Participant

Okay. And this question, maybe I should have asked prior. But with the click-and-collect, it's just grocery right now. Is that correct?

A - Steve Bratspies {BIO 18295554 <GO>}

No. Actually, it includes general merchandise.

Q - Unidentified Participant

It does.

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. So when we started, it was primarily grocery. And it's one of the reasons we call it Online Grocery as our internal vernacular. But really, we're talking about it much more broadly than that. So it's better to refer to it as click-and-collect. And one of our big focuses is to add more general merchandise to that basket. One, obviously there's a margin benefit in terms of doing that. So we can mix it out a lot better. But the other component is we want click-and-collect to represent the traditional Walmart experience, which is one-stop shopping. So we need the customer to think about click-and-collect holistically. And we can serve all of their different needs. And we're rapidly expanding the GM assortment that's available.

Q - Unidentified Participant

And have you disclosed what percentage of the general merchandise is available for click-and-collect (at this point?)

A - Steve Bratspies {BIO 18295554 <GO>}

We have not disclosed the %. But it's a large majority and it's continuing to grow. There will be certain categories we just won't do because they will never be efficient enough. But in general, we want to be able to meet the broad base of general merchandise needs for click-and-collect.

Q - Unidentified Participant

Okay. Great. If we can maybe drill down to some of the category work that you've been doing. Maybe first focusing on grocery. Just maybe, could you start with some of the changes we've seen maybe in your grocery merchandising over the last year? Are there certain areas where you think share gains have accelerated as a result of some of your initiatives?

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. Obviously, grocery has been a large focus for us. And we've been pretty pleased with our performance, in general. Let me start with our fresh business. And we've talked a lot about it. And we think we've made pretty significant progress in fresh over the last couple of years. In terms of produce. And starting with produce, it's really the first thing you see when you walk in the door. We've worked on produce all the way from the farm through the cash register and really even into the customer's house because we're trying to drive increased freshness there.

But relooking at how we source, who we source from, the quantities that we're sourcing, how we then move that through our supply chain more efficiently, how it gets unloaded at the back of the store, we've almost completely changed all the store processes on how associates deal with product, how they stock the shelves, call the product. We've changed what the assortment looks like and the layout. So we've touched almost everything in produce. And we've seen a lot of progress, in addition to investing in price on it. So we feel good about the momentum we have in produce. There's more work to be done and more opportunity. And we're not nearly as good as we need to be and will be. But we feel like we've gained a lot of momentum. And that's resulted in share growth there.

The other parts of fresh, bakery and meat, have really improved as well. Just to spend a minute on bakery. Bakery is a business that's been growing incredibly well for us the last couple of years, double-digit comps. And a little bit of a different approach there. That was about simplifying the assortment. We were over-assorted in bakery. And the shopping experience was just a little too complicated. So we've reduced the assortment. The team dramatically improved the quality, got back to item price merchandising because it's ultimately what we do best. We're an item priced merchandising company, made that really clear a space. And bakery has improved dramatically.

So we feel pretty good about momentum that we have and the improvement we have on the fresh side of the business. But we're trying to really match that then with kind of center of the store and dry grocery as well. It's incredibly important. And the growth there has been a lot of changes in space, adjacencies, more intuitive to the customer. Private brand has played a big role in that. And price investment, which has continued to work and drive units. So we feel pretty good, in general, about the holistic body of work that we've done in the grocery business. Share has improved and continues to grow, which we're excited about. But we also realize we have a lot of opportunity in front of us. Everything that I talked about, we can continue to get better at. And we don't think we've reached the peak on any of it yet.

Q - Unidentified Participant

Okay. And you mentioned private brand. And again, if we could just maybe focus on the grocery piece before we go into the other categories with regards to private brand. I mean how much runway is left for increasing penetration? And what roles do you see for private brand versus national brand and how you balance that?

A - Steve Bratspies {BIO 18295554 <GO>}

Private brand has been -- we've been on a journey. And as I said, we're pretty pleased with the progress that we've made. And it starts with a philosophical difference or change in how we approach the business. I would say, in the past, we had a private-label approach versus a private brand approach. And I think there's a really important distinction between the 2 of those. My experience before for Walmart is packaged goods industry. And it was about disciplined brand management. And we're now running our private brands the same way you would expect any CPG company to run their brands, the way they think about product and quality and price and packaging, all those different components. We've brought that capability and that approach to Walmart in our private brands and grocery. So particularly Great Value and the Equate brands, which are our 2 biggest ones.

So a lot of discipline, a lot of product quality improvement and really thinking about the role that it plays, specifically inside of each category. At the same time, we've got rid of a lot of brands. We just had a lot of private brands that weren't a value to us and it was cluttering the assortment. So we simplified the assortment, simplified our portfolio and then really started to use it as a proactive lever to drive growth for our business.

And I would tell you 2 reasons why private brand has been successful, beyond the fact we're just better at it, is customer today, millennial customer is just intuitively more open to private brands and more accepting of private brands. I think part of that is just they're a little bit different and part of it is everybody's gotten better. It's not just us. The industry has gotten better. So the offering is stronger. So they're more naturally accepting of it. And sometimes, when other brands, national brands, larger brands aren't innovating at the same pace they had been in the past, sometimes price gaps get too wide. And they price themselves out. So it allows space underneath. And our private brands have certainly grown because of that. But it's something that we think can continue to grow.

We still are probably under-penetrated versus some of our competitors. And we're actually okay with that. I don't have very specific clear targets on I want this level of penetration. We really let the customer choose. And if the customer wants more private brands in that area, we will give them more private brands. If they're not interested, we'll pull back. So there's no actual specific target. But it certainly has been increasing.

Q - Unidentified Participant

And do you feel, like in grocery, most of the categories lend itself to having a private brand?

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. The vast majority of them do. There's only a few that we don't have private brand in. So there's opportunities everywhere. Now that penetration ranges. Some are more highly penetrated than others. But most of the categories, with a few exceptions, private brand can play in.

Q - Unidentified Participant

Okay. And just we were curious. Has there ever been an example of when you've pursued a private brand -- and maybe not a brand. But within a category where it just didn't work? And how do you assess that? And what are kind of the improvements that you need to make if it does not work?

A - Steve Bratspies {BIO 18295554 <GO>}

We tried chocolate. We had Great Value chocolate at one point. It didn't work. And the reason it didn't work is it just wasn't good enough. And we couldn't get the product to a point that we were really happy with it and we thought it could compete at the level that it needed to. So we pulled out of it. So that's usually one of the best examples that I have. That's a category where everyone has their different brand that they like and different flavor profile that it worked. And ours was okay. It was good. But I don't think it was better than or up to match with some of the other ones. So we just pulled out of the category and said that's not an area we're going to focus on.

Q - Unidentified Participant

How quickly do you realize something like that? I mean chocolate is very specific. But I mean, in general?

A - Steve Bratspies {BIO 18295554 <GO>}

Pretty quickly because the sales weren't there.

Q - Unidentified Participant

Ever? Yes.

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. It just didn't sell that well. So we said -- we gave it some time, obviously. Let it sit. But it just wasn't good enough. So we took it out of the module and moved on.

Q - Unidentified Participant

Okay. So if we can move on from grocery to more of the general merchandise categories. And I know you're doing a lot of work here, especially in the apparel and home categories. Maybe you could maybe start out with just what we've seen in the store and what you see -- what you've done online with the home and apparel categories.

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. That same -- what I would say -- I'd start with this, that same kind of discipline from brand management perspective we talked about in grocery applies to the general merchandise side of the house, too. So all those disciplines, that's all consistent. And we're doing a much better job on that front. For home and apparel, first I'll start with apparel. We're spending a lot of time on and a lot of effort on a project that we call apparel reinvention, which is a re-layout and rechange of the apparel floor and what it looks like, the height of the walls, the height of the racks, the signing, the navigation, all the things to make the pad more appealing and easier to shop and more engaging to the customer.

In addition to that change, which is being rolled out, a lot of work has been done on product and branding. We introduced 3 new brands at the beginning of this year: Terra & Sky; Time and Tru; and Wonder Nation in kids. All are doing really well. And we're pleased with the performance of those. We also kind of revamped George inside the U.S. portfolio for men at the same time. So a lot of work, a lot of investment to get that product to where it needed to be on spec, on fit, quality of fabric, all of those different things coming into it to make sure that we continue to lean into that business, while we do an incredible basics business inside of apparel at the same time.

So when it comes down to basics of socks, underwear, we sell an incredible amount of that product. Some of it branded, some of it private label. So we want to hold on to that while we surround it with additional new brands. And that's worked pretty well. So we're going to continue to do that and continue to look for new opportunities to leverage brands, whether they're online brands or whether in the store.

In home, we're not as far along with a reset in store. We have one that's coming that we really like. That makes home also easier to shop. The adjacencies are much smarter than they've been in the past in terms of how people are going to shop. And again, some lower counters, better navigation. So you'll see that start to roll out next year, which I think is going to make us a lot better.

But I would tell you, the biggest improvement at home. And what I think the team has done the best job on is product quality. The product is just simply better. We have work to do. There's plenty of opportunity. But we're using online ratings, 4-star ratings. If the product doesn't have 4 stars online, we're not putting it in our home assortment. So we're starting to cross that digital and physical line. And the team has done a nice job of continuing to grow and build that business, leveraging our big brand mainstays in there and also -- and better homes and gardens and also national brands at the same time. So we have a lot of great experience in that kitchen appliance brand with some of the national brands. And they continue to grow.

So both of those are a big focus in stores. And recently, we talked about it in our lease. They're performing better online as well. And that's been a focus for us to drive margin, improve profitability through those categories. And some of that is adding new brands and some of it is just managing the assortment. But good momentum there.

Q - Unidentified Participant

Do you feel you're at a point where apparel and home could be the sole reason why somebody comes to Walmart? I think -- correct me if I'm wrong. But I would think grocery is the bigger traffic driver into the store. Do you think apparel and home will get to a point where that drives traffic on its own?

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. I would tell you -- I mean, yes, grocery is obviously the biggest traffic driver we have because of the velocity. For some customers, it's already there. Our challenge is to grow that pie, right? And we have plenty of customers who all they do is buy home and apparel at Walmart. And that's why they're very sizable businesses. Now they don't appeal to everybody and they never will. And we understand that. We're going to continue to expand from a good, better, best assortment. We know we have opportunity to move into better. And we'll see about best in terms of apparel. But we -- what we have to do is stay incredibly focused on our core assortment, on our core customer while we expand. And the trick is don't lose the core. And we've gotten away from that a little bit in the past. So our incredible focus and our maniacal focus is serve our core as we expand. So we're going to stay with good, better, best. We're going to continue to try to climb that ladder. But we're going to make sure we don't lose focus on the core as we do it.

Q - Unidentified Participant

Okay. One thing that we've heard from you guys over the years is just increasing the number of SKUs available online. But we were curious about that philosophy of increasing SKUs in the stores. Are there certain categories where you're trying to either increase or decrease the SKUs? And does the assortment vary from store to store and region to region?

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. In terms of store count -- or SKU count, sorry, in a store, we roughly carry in a supercenter 100,000 to 120,000 SKUs. And there's a lot of movement inside of that.

And I would tell you, as I walk a store and I work with my buyers, there are categories that I think we are over-assorted. And I think we have a lot of opportunity to simplify the assortment. At the same time, we have categories that are under-assorted. That need work. And we can add more to do that. So it's really a category-by-category decision. I'm always very careful to give directives on you need to reduce SKUs because it's a bottoms-up business. Walmart runs best when we run it as a bottoms up. And we let the buyers do their thing. I'm there to help and help navigate. But they need to do the thing. The challenge I give them is I want you to have the broadest assortment you can that's efficient at the shelf. It has to be efficient. So we have to help the stores from a productivity perspective. And that means we have to have the right holding capacity on the shelf. We need more shelf-ready packaging. We need inventory to be right. It needs to be easy to stock. All those kinds of things. Once you fit inside of those criteria, we want to serve as many people as we possibly can and as broad of assortment as we possibly can. So you'll see us adding in some areas and detracting in others. It just depends on the category and the situation of the business.

And in terms of does assortment vary store to store? It does. But the vast majority of assortment is consistent. Then we try to get to, what we call, store of the community, of making sure that the store represents that community. And some of that is at a very granular level in grocery. Some of it could be the local sports team or making sure, like if you're near a lake, we probably should have more fishing space and boating space. If you're in a -- if you're in the desert somewhere, having a big section of life preservers and paddles for rowboats and things like that probably doesn't make a lot of sense. So we try to customize by sort of the community when it makes sense geographically or if the demographics are different. But the vast majority of our offering tends to be pretty consistent.

Q - Unidentified Participant

Okay. If we can move on to the topic of price investment. This is a question that we get a lot across all the retailers that we cover. But it's a complex and fluid topic, we understand. And you guys use it very effectively. Could you maybe walk us through, just generally, how you think about price investment? But then when drilled down to more recently, it sounds like Q2 is maybe a little bit higher than Q1 in terms of price investment and why that was the case.

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. Let me do it in reverse order. Let me talk about Q2 versus Q1. What I would tell you is we set a budget for price investment for the year and then we break that out quarter to quarter. You shouldn't read Q2 as any real change in the marketplace or change in our strategy. Some quarters we hit, as we roll out geographically, a few more stores than other quarters. And those things change us because we do it by market. So no strategy change or anything, Q2 to Q1. That's just how we budget for the year. And we'll deliver on the budget that we have for the year we set for pricing.

In terms of how we approach it, the thing that we're most focused on is making sure that we deliver on our everyday low price promise. And part of everyday low price promise is not only leading on price. But a consistent downward pressure on price.

And Walmart thinks about pricing a little bit differently than most other retailers and a lot of manufacturers in that we don't ever talk about how high of a price we can command for an item. We actually go the other way and say, "How low can I sell this item, still make the margin that I need to and sell a lot more?" which is a bit different thinking than a lot of other people in the industry.

So with that as the backdrop, we built this pricing strategy that is very focused on serving customers. I won't go into too much detail for competitive reasons. And we don't really share the strategy. But what I would tell you is we use an awful lot of data to understand where pricing makes the biggest difference and how we should price effectively. And quite frankly, we're much smarter on it today than we were four years ago when we started this. So we're using data, changing our approach where it makes sense, making sure we're pricing appropriately against hard discounters and managing that.

We have a lot of regional competitors that we need to deal with. But we're just really focused on continuing to keep prices low, maintain the price gap that we need. And people ask me all the time, why are you doing, how long you're going to do it. We're doing it because the customers are responding. Our traffic continues to grow. Our units continue to grow. Units per basket, which is a metric I look at all the time, continues to improve. So as the customer continues to respond, we're going to continue to invest and drive that business as we go forward.

Q - Unidentified Participant

And is there any role -- or have you embarked on any kind of dynamic pricing when it comes to either the store or online?

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. We want to be consistent on pricing as much as we possibly can. We're not perfect. There's always opportunities. But one of our -- one of the key premises of everyday low price is the consistency. And we think it builds a trust with our customers and that they trust Walmart on price and they trust the consistency. Customers really get annoyed when they buy something and they come back a week later and they see it, it's a different price, particularly when you get into more expensive goods, like in general merchandise side of the business. So we think consistency equals trust. And we think trust is just a fundamental part of our brand and how we try to work with customers.

Q - Unidentified Participant

Okay. Great. Last question on price investment. Is price investment more of a grocery-specific conversation? Or is it across the board?

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. It's across the board. But it's sequenced. So recently -- or up to today, the vast majority of our spend has been on the grocery side and has been our focus. Next year and going forward, as we've kind of completed the geographic rollout, it frees up some of the budget to move over and be more focused on general merchandise than we have in the past. We'll still continue and spend and invest on the grocery side of the business. Back to what I said earlier, consistent downward pressure on pricing and always need to make some adjustments. But because we're not reentering new markets, we now can spend more on the general merchandise side and attack some of the categories where we have opportunities over there to increase our price gap.

Q - Unidentified Participant

Okay. Great. When you last spoke to The Street, management raised their full year guidance on top line. I wondered if you could maybe walk through the factors that are driving that primarily in the second half of the year.

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. We have good momentum in the business. We like the underlying dynamics of traffic, basket size. We like the programs that we have coming in the back half and we continue to take share. So it gives us the confidence that the business will continue to improve. And we're -- I promise you, we're not resting on our laurels. There's a lot of work going on. And we think we still have opportunity to do better.

Q - Unidentified Participant

And when it comes -- going back to the grocery pickup, I'm not being very efficient with my questions, sorry. One thing, one question on that we get is that once you are through the grocery pickup -- or I'm sorry, the click-and-collect since it's more than just grocery, what happens when you get all your stores online? How do you comp the success of that launch in those stores?

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. What we're seeing is stores that have been open over three years, they're still comping in Online Grocery. So we feel pretty good that there'll be continued growth. We continue to see new customers. The repeat rate continues to grow. And I think that, as we expand the assortment and you have even more opportunities, there's no reason to think that, that won't incur more occasions as we go forward. So long term, way, way out, we'll see how it plays out. But what I can tell you in the data set that we have today is the stores from the beginning are just continuing to comp positive on Online Grocery. So we're encouraged.

Q - Unidentified Participant

And is there any way to tell how much of that comp is being driven by a brand-new customer to Walmart?

A - Steve Bratspies {BIO 18295554 <GO>}

We can tell through traceable tender and things like that. It's not data that we actually release and talk. But we have the ability to understand the customers that are new, who's moving across channels and things like that. And ultimately, what we're trying to get to is. And I think I mentioned it earlier. But we don't care which channel you shop. We just want you to choose Walmart. And what we're seeing is customers come in through one channel and adopt other channels. Other times, we're seeing our core customers just spreading their volume. So it varies. But we're seeing a lot of movement across channels and people using different channels based on the occasion, what their need is at that time.

Q - Unidentified Participant

Is there any major category that is kind of -- that you can lean into in a more and meaningful way that the customer is asking for, that you think is missing as you continue to refine the store?

A - Steve Bratspies {BIO 18295554 <GO>}

Well I think one of the big ones that we're leaning into is adult beverage. So alcohol is something that, I think, we're under-shared in, under-spaced in. And we've got plans to address that as we go forward. It's a very large business that we don't have a huge share in. And there's all kinds -- there's all state rules and local rules and all those things. So it's a very complex business that you have to navigate. But it's a business that, we think, is a big opportunity for us to address. And we've got a few test stores out there right now with very different sets and expanded space that we're pretty excited about and we think can make a big difference in the business.

Q - Unidentified Participant

And do you have an example of another category that you may have leaned into that's resulted in maybe better-than-you-thought expectations? Or...

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. I don't know if better than expectations. But if you look at one of the businesses that we are fundamentally disadvantaged at from a size perspective is hardware. And we've got a new layout in tools that is rolling out through all of our remodels and driving significant comps in that business that we feel pretty good about. We're never going to match assortment with Home Depot or Lowe's in that front. So the challenge when you work in a supercenter mass merchandiser as a merchant is you have to make some real choices because you just can't. In total, we carry a lot. But if you're an individual business, you're undersized in space versus your competition. So you have to make some really specific choices. And I think the team in -- and we call it Tool World, has done a really nice job adding some products, changing the assortment, simplifying some other areas. And we're seeing a lot of good progress there.

I would say the other area that we've leaned into and have done well in is toys. Now obviously, there's been disruption in the industry there and a big change in the industry. But beyond just having more inventory and selling in a couple hundred stores, we went and actually changed the physical space and added more counters to enable that business, which is not inexpensive. And it's not without its complications. But we're finding those opportunities and leaning in aggressively. And when we do that, we seem to be having pretty good success so far.

Q - Unidentified Participant

Okay. Great. If I can ask kind of a bigger question on just the U.S. e-commerce strategy. It seems like you've been redirecting some of your investment spend towards the core of Walmart.com. So I just wondered if you talk -- could talk about what some of the bigger areas of investment have been.

A - Steve Bratspies {BIO 18295554 <GO>}

I think the biggest focus for Walmart.com is assortment and how do we get more efficient and profitable in the business. And we're working towards that and we have a lot of work to do as we go forward. We're working on mix and managing mix more effectively, working on contribution profit for each individual item and how that plays out across the site. When we moved to NextDay delivery, which is a bit counterintuitive for some people. But costs actually go down because we forward deploy inventory and mirror inventory the best couple hundred thousand SKUs across all our fulfillment centers. Then when we ship from there, we actually have fewer split ships and reduce freight costs, less air and all those kinds of things. So it actually gets more efficient and effective in terms of doing that.

So really working on focusing on the core business and those couple hundred thousand SKUs that drive the majority of the business. So the way we're thinking about it is kind of almost from the inside out in that we're trying to use the stores as forward kind of distribution centers, as in fulfillment centers, as we go forward. We add the e-commerce fulfillment centers around it and you start to create the connectivity and the ecosystem for moving product more effectively and efficiently to be able to serve more customers and the best -- on the products that they need the most. We'll still have 1 million to 2 million first-party items that we'll carry and ship. And at the same time, we'll build out marketplace. But we're really trying to focus on the core and then build out marketplace. And we've made some changes in our marketplace structure. Jeff Shotts, who was the CFO of e-commerce, is now in an operating role running marketplace, really focused on that every day. So we're kind of -- we're doing a lot of things at one time and trying to find that right balance and mix. But we'll continue to build the tail and -- but heavy focus on our core right now.

Q - Unidentified Participant

Are you able to speak to the marketplace opportunity and how Walmart is thinking about that longer term? And I guess one of the bigger feedbacks on marketplace is just the quality control and how you manage that. So...

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. I'm not an expert on marketplace. But I'll tell you, kind of at a high level, we still see it as a big opportunity. We may not ever -- we'll never be maybe as big as our biggest competitor in that space and probably don't want to be. I think we're up to about 75 million items on marketplace right now. So we've grown pretty dramatically over the last couple of years. One of the challenges on marketplace is filtering and making sure you have not only the right product. But avoid difficult situations. And we've had some of those with a graphic T-shirt or a Halloween costume and some difficult things that we wouldn't necessarily have chosen to put on the site. And we take action appropriately when that's found and it ends up being unfortunate. But we're working on that process of not only what are our official guidelines. But then how do you filter it and how do you manage it. So there's technology solutions that are coming to help us do that better. So we get the best of the best and avoid some of the more complex areas.

Q - Unidentified Participant

Okay. We're asking all the management teams that sit with us at the conference for questions. So I'm going to launch into those now. The first is. And we've touched upon this a little bit. But your expectation for the macro environment in the second half of 2019 in the U.S. relative to recent results, better, same or worse?

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. I'll tell you, the data that we looked at and that we have tells us that our customer is in pretty good place and is feeling pretty confident based on their behavior and other surveys and studies that we do. So we feel positive about how the customer is, how they're responding, how they're spending, their attitudes. They feel pretty good. So we're positive on the macro outlook. Now if I actually knew, I'd be doing a different job than I'm doing right now. But I think from our customer perspective, with the data that we look at, it's still pretty positive.

Q - Unidentified Participant

Okay. The second question is on inventories. Do you expect inventories to go faster or slower than sales in the second half?

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. I mean our objective is always to have inventory growing slower than sales. I would tell you, we came out of Q4 heavier than we normally would. But we feel really -- it's all good inventory. And to me, that's actually the most important part, is the numbers will fluctuate a little bit quarter-to-quarter based on timing. But our inventory is really clean. We were heavy because of a couple of market opportunities that we took advantage of and we bought up on the mirroring of inventory across the FCs, drives inventory up a little bit. We've had some issues with the way we're importing product, bringing in stuff from the East Coast versus the West Coast, which adds a little bit of in-transit time. So there's a few different things that have driven it up. But our goal is always to manage inventory at lower than the rate of sale. So we'll continue to work on that inventory as we go forward. But the most important thing for us it's good go-forward inventory and not backlog, if anything.

Q - Unidentified Participant

Okay. Tariffs, which haven't come up yet. The question is, though, what is your biggest lever to mitigate tariff pressures? Is it moving production or supply chain reconfiguration, negotiation with vendors or price increases?

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. I didn't know if you'd ever get to this question.

Q - Unidentified Participant

I got to it.

A - Steve Bratspies {BIO 18295554 <GO>}

That's my favorite. So obviously, it's complicated and there's a -- I wouldn't tell you there's one lever. We -- we're using lots of them as we go forward. And just to give everybody just a little bit of backdrop on how we think about this and the approach that we've taken. So list 1 through 3 came out and I was really pleased with my team and how they handled it and managed through it. And we built a very disciplined playbook, literally a playbook that the buyers go through and the tools and the levers that sort of teach everybody the best way to handle this. And -- but it continues to grow as they learn new things as we go forward. And if you look at list 1 through 3, in general, we mitigated it. There were a few prices that we took up. But they were not -- there's no consequence to that. Units continue to grow at the rate that they were growing. So it really didn't have any effect. So we were pretty pleased with that. And what -- we used lots of different tools to do that. There was some price decrease. But a lot of negotiation has driven that.

List 4 obviously is more complicated and covers a much broader range of products. So we're using the same playbook, though. And probably, the most important part of that is we literally go through item by item by item. And sometimes, as you think about tariffs. And I was talking to a group earlier, you get lost in the big numbers, right? And we all talk it's this billions, it's that billions. It really comes down to an individual product. And our team literally lays out every single item and goes through and makes decisions on how that item, inside its category, how we can mix, what are the different levers, can we negotiate, can we source it differently, can we just push back and negotiate it, is there something we can do differently on supply chain. There's a lot of different ways to think about it. Our last resort is to raise prices. And I would tell you that, back to the point I was making earlier, we constantly want downward pressure on pricing. We don't want them to go up because we think that's best for the customer. If we can't deliver on what we need to deliver, then we will have to move some prices. There's no doubt. But that will be our last resort. And we'll pull all the other levers that we have to, to get there.

You mentioned moving volume to other places. It's more of a longer-term play to do that. I would tell you that the last time I was in China, I met with the top 15 of our suppliers and that was a hot topic of discussion. They are -- there is activity around that. They are moving. But it's not something, with our volume, you can flip a switch and just move to another country. So that's a longer-term play. But that is going on.

Q - Unidentified Participant

Okay. Just one follow-up question on that. You said you had a lot of success in mitigating the impact, list 1 through 3. Can you talk about how much harder it was to mitigate at 25%, 30% versus 10%?

A - Steve Bratspies {BIO 18295554 <GO>}

Yes, good stuff (for -- just from) the math. But it -- but I would tell you, though, again, it goes back to the individual situation because there are some areas that we get 25%. And at 25% you can handle it just because the dynamics of the category, the nature of it, the spreads you have, there's a lot of different ways to approach it. And there's no one way you could get it, right? The other advantage that we have, quite frankly, is we have a really big box to mix it out across, right? We have grocery and if we have to spread -- I can think holistically about the entire portfolio. We don't have to just apply a tariff to an individual item. We can think about how to move it.

And the other part I would just remind everybody, as we think about tariffs, because I know it's on the top of everyone's mind, is if you think about our total business, 2/3 of our business is sourced here in the U.S. So now you have another 1/3 left. And not all of that is sourced from China. So while it's still a big number. And I don't want to downplay it, it's obviously a big impact, it's not as big as some people think when they think about our total business.

Q - Unidentified Participant

I would imagine, too, being a global company, that there's probably some opportunity to, if you still have production coming out of China, to ship to those non-U. S. countries and not have to be subject to a tariff versus maybe shipping to the U.S.

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. We have to be careful on how we do that just because of the restrictions and how that moves. But I think anything coming out, we still get hit with, I'm not exactly sure. But yes, we have -- there's different ways to leverage global sourcing. And what I would tell you is one of the advantages we think we have, one of the benefits is we have a very well-established global footprint and global sourcing organization. And we're already set up in all these different countries to manage change and manage the influx of support. So we've got a pretty good infrastructure that we can lever as things evolve over time. At the end of the day, though, we're going to import product from China. I mean don't -- we're not moving everything out of China. Our suppliers won't move everything out of China. It's just not practical and probably not the right thing to do. But there will be some movement.

Q - Unidentified Participant

Okay. Then our last question that we're asking everyone is, over the next two years, do you expect your store base to be larger or smaller? I know I'm talking to Walmart. But just curious what the answer might be.

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. We haven't been given direct (guidance) on that. But I'd tell you, if you look back the last couple of years, we're not building stores at the rate that we used to. And I'd probably suspect that our investment will be more in technology capability than it will be in stores going -- new stores going forward. We'd rather (be spending) that money on remodeling our current asset base.

Q - Unidentified Participant

Then my last question before we open it up for a few minutes to the audience is, just with the amount of investment that's taken place and especially in technology, I wondered what investment in technology has made your job easier.

A - Steve Bratspies {BIO 18295554 <GO>}

It's a great question. There's a lot of different things. One of the areas that we're spending a lot of time on, in merchandising specifically, is negotiation and merchandising tools for our buyers. And I'd say there's 2 big things.

First, on the negotiation side. Coming up with new products that enable our team to prepare for negotiations faster and have the capabilities and the data that they need to be prepared. There's always the old joke of you have a Walmart buyer sitting at 1 side of the table and an SVP and 25 analysts from the largest manufacturer sitting across the table. And what we're doing is equipping our buyers with the data that they need to be more proactive in discussions with suppliers. So instead of the suppliers coming to us first, we're going to them with here's how the business opportunities lie. So there's a lot of data being collected and produced into, we call merchandise -- or negotiation tool that's going to help our team be a lot more progressive. I saw the latest prototype of that just last week and I'm very excited about that. It's going to be a big deal for us.

The other side on technology is on assortment. And we have a lot cleaner insight to transferability and substitutability of merchandise. So when a buyer is making assortment decisions and deciding, well, do I want to keep that brand, do I want to move that brand, do I want to cut this item, the ability to understand where the demand is going to transfer or what product can substitute for another or what brand can substitute for another is incredibly empowering. And we've built that data capability through technology over the last couple of years. And it's making a big difference.

So on the merchandising side, it's using technology to use data better. Then there's a lot of technology being added to the stores to drive efficiency at the same time. So whether that's how we unload trucks, robotics, self checkouts, the front end, all of those things are helping us create the leverage that we've been able to create for the last couple of quarters. So it's a big focus for us and a big investment. And that's one of the reasons why store investment probably just won't grow and we'll spend it on our current fleet.

Q - Unidentified Participant

Great. Okay. We can take a few questions, please.

Steve, could you please comment how Walmart has historically looked at marketing as an expense? And now currently, Walmart is looking at marketing as an investment where you're working between your team power of one, Publicis with the best copy, the best creative, the best advertising and media buying and placement. So you have the highest efficiency, the highest effectiveness, best anywhere in the Americas to convert customers from either viable competitors or contracting or collapsing competitors in food, drug, discount and specialty.

A - Steve Bratspies {BIO 18295554 <GO>}

So I'm sorry, I missed the first part of what you're saying. So you're trying -- our approach to that or...

Q - Unidentified Participant

The -- your marketing and advertising has really evolved from something that was historically looked at as an expense. And now you're looking at it as a strategic investment where you've gone to best in the business and really accelerating your growth versus all channels of competition to convert more and more customers to Walmart and getting existing customers to buy more in terms of efficiency and effectiveness of the buying. But also the best copy and creative in the business with the work you're working with Publicis.

A - Steve Bratspies {BIO 18295554 <GO>}

Thank you. Sorry about that. Yes, I think -- we believe market -- I mean, I grew up in marketing. So I'm still a marketer at heart. I think leveraging the message that we have is pretty compelling. And we're very proud of our brand, we're very proud of the concept of save money, live better. We think that resonates as a true brand and needs to be marketed that way. And there's -- what's great about marketing at Walmart is you have this incredible brand, this incredible brand message and you have all these assets underneath to activate, whether it's click-and-collect we talked about, whether it's new brands and all kinds of products and services. So it's kind of a -- it's a great marketing job to have and to leverage. And we're being more proactive than we've been in the past and making sure that we're driving a holistic message, using great partners to help us get there. I mean the world has changed in the last 10 years since I was in marketing with the way social media is running. I mean you go to market very differently than you did 10 years ago. And we're leaning in to use all of those different channels and partnering with the right people to help us get our message out there.

Q - Unidentified Participant

Great. So my question is a follow-up on the tariff. It's really interesting that you talked about the difference you're seeing in terms of your ability of negotiating with vendors, depending on the product or product category. If you can just give us more color in terms of where you're seeing more opportunity to negotiate, where there's less flexibility, that would be great. And similarly, in terms of in the medium to longer term, moving the supply chain out of -- outside of China, what kind of product category where you're seeing most opportunities, which are more likely to stay in China. I imagine they have a lot to do with regulation, product complexity and labor. But given your vantage point, love to hear your insights.

A - Steve Bratspies {BIO 18295554 <GO>}

Sure. I won't get into specific categories or specific suppliers and who's more willing to negotiate and who's not because it really depends on the situation. I'll tell you, we've had success with categories -- the same supplier with some categories and not others because it also depends upon their cost structure and where they are. So it is literally an item-by-item approach, not even a supplier-by-supplier or category-by-category. It really goes down to the item level.

And we've had success at different levels. But we're often able to mix it out. And one of the examples on mixing. And I used this with a group earlier. So I apologize, I'm going to use the same example. We've had an occasion where we had small kitchen appliance that was subject to the tariff. And there's a wide range of product. And part of the category was growing really fast because it had the newer technology on it. And the other part of the category really wasn't growing. We had volume there, we had to keep it because of our broad assortment of good, better, best. But it wasn't where the growth is. So we thought very carefully about if we are going to take pricing, we're not going to take pricing on a high, fast velocity growth part. We're going to put -- maybe burden the other part of the category a little bit more. So we're mixing it out very differently. And it depends upon the individual situation. Other times, it has been -- to your question, we just said no. And we've given them reasons why we push back. And it has been absorbed. So it varies. And there's not one case that fits all.

In terms of where there's opportunity outside, (boy,) different suppliers have different views of that. And it often comes down to how they want to run their businesses. And I don't necessarily think you'll see, in a short term, massive industry shifts versus supplier shifts. Now in the long run, that might change. But it's more a supplier-by-supplier base right now. There's a few trends inside of a couple of categories. But not everybody is moving.

Q - Unidentified Participant

I'm just going to take one more question. And we'll wrap it up.

Steve, you've mentioned CPG companies a couple of times now. Could you address the question of these companies -- of many of these companies establishing their own DTC, direct-to-consumer relationship with consumers and how you're handling that? So it's about the channel disintermediation question. But also a who owns the customer question.

A - Steve Bratspies {BIO 18295554 <GO>}

Yes. There are some of them that are -- they're working on those businesses. I would say they're relatively small today and haven't been disruptive. But we have a lot of very lively conversations about that and how we're going to handle that and the businesses that they're planning on building and growing. Fundamentally, we think we're the best way to reach customers. And we think we're the most efficient way to reach customers and we think we have the broadest reach and create the greatest access and the best experience. So we're happy to have those discussions. And I'm very confident that when we lay out our case and explain to them why we're a better choice, many of them listen over time. Some don't. And I wish them well in terms of how they build that out. But we're going to continue to run our model and build our model because we think it's a winner.

Sometimes we learn from them about why they're doing it. We think maybe we need to do some things differently to make sure we're engaging as broadly as we can. But I think the Walmart brand is pretty powerful. And I think it is well positioned to serve the vast majority of the U.S. We have -- 90% of Americans live within 10 miles of Walmart. That's a pretty impressive and hard to compete with infrastructure. And as we continue to leverage the forward-deployed inventory and using our stores' fulfillment centers over time, the efficiency that we're going to bring out of that is going to be really hard to compete with, especially kind of on a one-off brand basis.

Q - Unidentified Participant

Okay. Thank you. So much for joining us.

A - Steve Bratspies {BIO 18295554 <GO>}

Thank you. I appreciate it very much.