Goldman Sachs Global Consumer Conference

Company Participants

- Doug McMillon, President and Chief Executive Officer

Other Participants

- Kate McShane, Analyst, Goldman Sachs

Presentation

Kate McShane {BIO 7542899 <GO>}

Hi, everyone. We're going to get started, Can everyone hear me? Hello, we're going to start the afternoon session now. We're very happy to have Doug McMillon here with us, Chief Executive of Walmart. You need really no further introduction than that, so I will turn it over to you for...

Doug McMillon {BIO 3063017 <GO>}

My name is Doug and working with Walmart. I'm excited to be here and have a conversation. Kate, it was kind of to give me just a minute to kick it off. So if you were with us in Florida at our Investor Conference there earlier in the year and we talked about the opportunities that we've got from the investments we've got looking ahead, and the fact that we believe we can continue to grow sales, grow operating income faster than sales, and improve return on investment as we go. I'll just quickly repeat, as it relates to driving that topline we feel well-positioned with brick-and-mortar, with stores and clubs, with curbside pickup, and with various forms of delivery, we expect to be able to continue to drive growth because we can serve people how they want to be served.

Operating income gets mixed up over time through the combination of productivity improvements, largely fueled by investments in automation and by changing the shape of the business model. As we've been able to scale digitally and drive eCommerce, grow a marketplace business, grow an ad business, grow data monetization, fulfillment services, not only in the U.S., but in other markets, the shape of the income statement itself changes. And then thirdly, because operating income is going up, we've got an opportunity to grow ROI as we go. So no new updates as it relates to the algorithm we've been using or the strategy, it's very consistent and I'm feeling very repetitive these days.

Kate McShane {BIO 7542899 <GO>}

It's good repetition now, it's all good news. So thank you again for joining us. We do have a bunch of questions really focused on the algo and profitability, but I thought we could start first with just a state of the consumer. Just given your size and scale, can you talk about maybe the evolution of what you've seen this year with the consumer and how do you feel that the health of the consumer is going into the back half?

Doug McMillon {BIO 3063017 <GO>}

Yeah, we today operate at 19 [ph] different countries and we see commonality across those markets in terms of how people are feeling and behaving. In the U.S., things are better than I would have expected them to be when we started the year. I was concerned about the amount of inflation in categories like dry grocery and consumables, how that would impact discretionary purchases, had an eye on the consumer balance sheet, all those things that we were all thinking about at the beginning of the year, but things have held up better than I would have guessed, and I think the employment situation, wage increases, some pockets of disinflation are helping that. So we do see some behavioral change for some customers that are particularly pressured from a budget point-of-view.

We do see pack size changes, moves to private brand, all those kinds of things that you historically have heard us talk about, but not everybody is in the same situation, and in our case, we've been able to attract customers across income cohorts, which has improved our situation as we've been able to grow share. So I'm feeling pretty good about where the consumer is in the U.S. and encouraged by what happened with back-to-school, as we reported at the end of the second quarter, back-to-school started off strong and normally that means that holiday is going to be good. So I feel pretty good about the back half and our position in it.

Kate McShane {BIO 7542899 <GO>}

That's great. And on the last call, you did sound more optimistic about general merchandise in particular, could you maybe talk about still down, but in terms of what you're seeing, is there a way to discern maybe how much is the shift in prioritization? How much is the -- just the easier compare of the LAP and again, how should we think about bigger ticket items when it comes to general merchandise?

Doug McMillon {BIO 3063017 <GO>}

Yeah. Lots of variables moving around and when we started the second quarter, what I was expecting general merchandise to look like was more negative in terms of percent of total than how it turned out to be. So on the call, I was talking about the fact that general merchandise was better than I expected. One of the things that's happening is general merchandise prices are coming down and we've seen food and dry grocery, think of the dry grocery, consumables, paper goods, cleaning supplies, that level of pricing has leveled out to an extent, and with that combined with the lower prices in general merchandise and the strength of our customers overall, performance was better in general merchandise than I would have thought it would have been.

Food and consumables have still gone up as a percent of total and I think that will continue through the year, but our thoughts are forecasted of what we thought GM [ph] was going to look like for the year, we were worse than what's actually happening. And I do think that, having seen the assortment for Halloween, Christmas, and the holidays, I think we're in a pretty good spot and that customers are going to feel some relief as it relates to pricing, Take the toy category, for example, some price points driven up over a two year period and as I look at the pricing for the balance of the year, we've got some great price points in toys and I think that's going to help us drive demand and that's true in some other general merchandise categories as well.

Kate McShane {BIO 7542899 <GO>}

And could you maybe talk a little bit about how general merchandise has evolved for you over the last couple of years, because that was the focus on the Q2 call as well in terms of the investments you've made there and how that's changed?

Doug McMillon {BIO 3063017 <GO>}

That's our heritage. Most of my career was spent in merchandising and general merchandise categories and we love those categories. Obviously, food and consumables are important to us, but we want to sell the whole basket, and we've got opportunities in apparel and home, in particular, to have a bigger business and a bigger percent to total higher market share and that's a combination of what happened in-stores and online. If I take the Walmart US supercenters, the opportunity we have with our remodels to improve our apparel presentation and I hope many of you've seen those stores and those remodels, it's a great one, and the better we do in terms of in-store presentation and product, think of good, better, best merchandising, the more that opens up opportunities for us in eCommerce, both in first-party and third-party. So when I think about general merchandise, I think about omni, in-stores, and e-com and it's 1P and 3P and the growth that we've seen on the marketplace side into merchandise has been terrific. I expect that momentum will continue. So customers can really find what they're looking for across the entire breadth of our assortment, which causes organic repeat to happen on our app.

Kate McShane {BIO 7542899 <GO>}

Okay. I thought maybe we could just touch on grocery quickly since I already spoke about general merchandise, but it seems like the promotional environment within grocery is still seeing so much rationale, and just as an EDLP retailer, how are you thinking about your relative price position today and maintaining your GAAP when it comes to -- pricing GAAP when it comes to grocery?

Doug McMillon {BIO 3063017 <GO>}

Yeah, in Walmart US, we're in good shape. Those of you that follow us closely know that over the last few years we've made a lot of investments on the income statement side with lower prices, some higher wages, eCommerce investments, and technology investments, and as it relates to those, we're in pretty good shape now and we're maintaining price gaps, and suppliers bring us -- think of dry grocery, consumables, as well as general merchandise, including direct imports, they bring us cost increases and decreases and we manage those up and down, and of course, we want to help customers save money and live better, so we're looking for the opportunity to drive rollbacks, but when that all plays out we end-up with about the same price gap and about the same margin structure on the income statement side. So today's Walmart is really focused on investments in things like automation and the balance sheet side of the equation more so than we were previously.

Kate McShane {BIO 7542899 <GO>}

And when it comes to deflation on the grocery side, how do you expect to manage that?

Doug McMillon {BIO 3063017 <GO>}

I think it will be slow. We'd like for us to see the opportunity for customers to have more disinflation and have lower prices faster. What we've seen over the last few years has resulted in dry grocery and consumables have a -- having a pretty big two-year stack inflation number and that's coming down a little bit, but not a lot. On the general merchandise side, things flipped faster. General merchandise prices are lower than they were a year ago, but not as low as they were two years ago. I don't think that GM gets all the way back down to two-year ago prices. And I certainly don't think that's going to happen on the food and consumable side. So when this is all said and done, there has been a bit of rebalancing as it relates to higher wages in the country. Inflation and higher prices are kind of with us. We'll see disinflation, but not all the way back to deflation, I don't believe, certainly not in the short-term.

Kate McShane {BIO 7542899 <GO>}

Okay, right. We started the conversation with your profitability algorithm and we think that's one of the most compelling parts of the Walmart long-term growth story is that improving profitability profile that we feel like we're just starting to see, of all the improvements, whether it be new business, improving eCommerce, lapping investment, what would you say is the tipping point to finally be getting to this part of your story?

Doug McMillon {BIO 3063017 <GO>}

I think it's happening quarter-to-quarter. I think you're seeing that play-out right before your eyes and it won't happen all at once, it won't happen overnight. The first thing that goes through my mind is how excited that I am and we are about the supply chain investments. I've been doing this now for more than 32 years and I've never seen an opportunity to step change the supply chain like the one that's right in front of us. And it's happening with the way we use data. It's happening with increasingly intelligent algorithms to help with demand forecasting and inventory optimization and it's happening with robotics. Specifically, automated storage and retrieval systems placed into our ambient DC network, our perishable distribution center network, our eCommerce fulfillment centers, and our market fulfillment centers that will be on locations with many of our stores. When you put those things together, we touched the product a lot less, our accuracy is a lot higher. Productivity will go up in the back room of the store as we receive freight that is palletized and more accurate as it relates to what's needed in a department or an aisle over time. That is a change that we've dreamt about and haven't been capable of doing, although for seven years now, we've been working with partners to figure out how to make the automated storage and retrieval systems work. And now it seems like we've got a pretty high degree of certainty as it relates to the individual projects as investments with a high and attractive IRR, but also the cumulative benefit of the way that new system gets put in place.

So when I think about operating income growing faster than sales, the first thing that I think about is how we manage inventory and the opportunity with the supply chain to increase productivity, so that we can have low prices, not have the customer pay for any of that and have an opportunity to reinvest or to flow through to a higher operating income level. The second component is the way that e-commerce has played out, the way digital has played out, and the impact that has on our income statement. So frequently inside the company, I'll describe it as the old income statement, looks like a store P&L. It gets sales, gross margin, SG&A, and operating income percentage at the bottom. The new income statement has got gross merchandise value, GMV, our marketplace, membership, advertising, fulfillment services, data monetization, and other components, that second income statement required a period of investment to scale e-commerce, 1P and 3P. We've made a lot of progress doing that. And what happened in 2020 and 2021 accelerated that progress, fixed-cost got leveraged more and contribution profit changed because of apparel and home percent of total going up and also because of the 1P, 3P mix. So that second income statement looks healthier, faster than we would have guessed, and in the end, it has a higher operating income percentage than the first income statement.

So when you hear us talk about business model change at Walmart, it's simply taking the previous income statement, still running that store business, becoming better and better at that over time, building that second one, adding them to gather to get a third business model and income statement that looks different than the first two. That's mentally how I think about it and that shift enables us to have a higher level of profitability as a percent of total without having to raise prices for anybody. It's just a business model change. So when you put together automation, productivity plus the business model shift, you get a more sustainable business that can grow more effectively over time and mix itself up as a (inaudible).

Kate McShane {BIO 7542899 <GO>}

And if we could maybe focus a little bit on the second income statement, starting with marketplace. Could you talk a little bit about how marketplace is different than maybe your competitors of how it's differentiated? And could you just discuss the fulfillment of marketplace and how you're approaching that?

Doug McMillon {BIO 3063017 <GO>}

Yeah. First on the fulfillment side, to have a great customer experience we want to fulfill more of those orders and so we've been building capacity over the last few years to be able to provide fulfillment services to a greater degree and that's happening, and that will continue to happen over time. More of the marketplace business will be conducted through our own fulfillment centers. We think that our marketplace is growing at a healthy rate and it results in the customer being able to have choice. When somebody thinks about buying anything and they want to go search or they want to go find a specific item, we want to be in that consideration set and that requires 1P and 3P. And now if you look at Walmart US, it's about 400 million items. We think of the marketplace as being global, not just geographic. The marketplace has cross-border aspects. We have a marketplace opportunity in Canada and Chile and Mexico, not just the U.S., so I think marketplace is being more of an enterprise in global business. That has been picking up momentum. We are fairly disciplined about screening sellers to make sure that the customer experience is good. So relative to some others, the vetting [ph] process, kind of like a bank goes through KYC, we want to know who the seller is. We want to measure transactional NPS and know that the outcome for our customers and members is a high-quality outcome, and that does get helped by fulfillment services. So we can scale it. We can go up in terms of the item count, the seller count, in terms of GMV and profitability, but do that in a healthy and sustainable way and that's what we're out to accomplish.

Kate McShane {BIO 7542899 <GO>}

Okay. The next pillar or area is Walmart Connect and we wanted to ask about in terms of, again, that second income statement, which continues to have very strong growth. Could you talk about the opportunity in the U.S. for Walmart Connect and internationally? And is there a profitability ramp in terms of what it will contribute over time?

Doug McMillon {BIO 3063017 <GO>}

Yeah. Great opportunity with advertising globally and we're excited that we're in that business and we have some differentiated offers for people, including the fact that you can serve up an ad to someone and have an opportunity to know a week -- two weeks later if they transacted in a store and not everybody can do that. So omni has some advantages as it relates to why you would want to invest in advertising dollar with us. To be clear on our priorities, we want to be where America shops. We want to be where Canadians shop. We're not out to have a short-term orientation, driving advertising up in a way to try and maximize something like CLTV [ph] in a way that in the long-term hurts the customer relationship and hurts the company. So we think about how often we serve up an ad and the way that shows up. And obviously, generative AI is going to change things. Personalization is going to improve. We think our advertising rollout is going to continue to go up. but we want to grow that in a healthy way. So I think first about 1P, 3P growth, is the eCommerce growing, we sell ads to suppliers, we sell ads to marketplace sellers. We want to drive growth on both sides so that the advertising business grows and scales and it will, but keep it in the right order of prioritization so that we don't end up harming the customer and member experience negatively and end up regretting that at the end of the day. So we grew 35% last quarter. We're excited about the ad business. It's not what I get up in the morning and think about first. What I think about first is did we serve customers and members well. What was the sales growth number? What was the GMV number? And advertising gets pulled along through that topline growth.

Kate McShane {BIO 7542899 <GO>}

Okay. The third area in terms of profitability is fulfillment, so separate from what I just asked with marketplace, but just kind of fulfillment on its own, you've been very much front-footed in terms of how customers get their purchases with the click-and-collect still being a fastest-growing option, what is the next phase and fulfillment if you had to guess how profitable can it be and can you build this out to serve other businesses and retailers?

Doug McMillon {BIO 3063017 <GO>}

I think we have already demonstrated that we can serve third-parties, whether it's last mile or it's fulfillment services, and that will just continue to get bigger within the U.S. and in some of the other markets that we've got. That automation that I've described will play out through that system. The Last Mile delivery network gets built out, will own more vehicles, will have associates doing more deliveries. Right now, the number of associate deliveries is relatively small -- very small compared to what happens with independent contractors on various platforms including the Spark platform that we operate for independent contractors to do deliveries, which is the biggest portion of our delivery business in the U.S. at the moment. So, I think about the whole system that I described earlier and the fact that others can join and use that system and gain benefits by doing so. When we can have a last mile order that's bigger or more orders and denser fashion, everybody wins, and we're able to help other retailers, large and small, participate in that systemic change to the supply chain that we're building out. So I think that just gets bigger and more important with us keeping the first thing first, which is transactional NPS for our customers and members to know that they're happy to shop with us.

Kate McShane {BIO 7542899 <GO>}

And then the last piece that we wanted to ask when it comes to profitability is data and loyalty membership, Walmart+. I think since you launched Walmart+ a couple of years ago, and I'm not going to ask you for a number (multiple speakers)

Doug McMillon {BIO 3063017 <GO>}

You kind of just did.

Kate McShane {BIO 7542899 <GO>}

I'm not going to. But you've added more benefits to the programs such as travel benefits with Expedia and Paramount+, how are you thinking about the program's overall offering now versus peers? And any color on the shopping habits of who these numbers are, what they buy versus traditional customer?

Doug McMillon {BIO 3063017 <GO>}

We want to have more members and we want that because we don't want them to think about delivery charges, we just want them to shop with us, and we want to use the data to try and serve them better. So personalization can improve. The more we have a unique identifier for a household or person, so that's important to us. We try not to emphasize membership, not just in the U.S., but in other countries because it's just one component of what we do and we don't want to accidentally create some short-hand where you all value our whole company based on that singular metric, which we've seen happen with some other other companies, so I don't know if we'll ever talk about what the actual number looks like. And they're going to be different types of memberships, not only at Walmart but at Sam's Club and other places. So the behavior we're looking for is organic repeat and bigger share. We want to sell across the basket. We want to sell across not only the store assortment but the eCommerce assortment and across 1P and 3P, and when you have a membership and you build this relationship both directions, you just end up with more repeat in a bigger wallet share and that's the way that we want to grow this thing. But again, like everything else, we want to grow it in a healthy sustainable way. So you'll see us, as we have been doing, stay really focused on the customer experience. For quite a while, you heard me and others saying, we don't want to grow Walmart+ too fast because we want to make sure that the customer experience is high-quality. And as we built that capacity, we've got better store pick and we put -- started putting more automation in place. I think the opportunity to grow that faster is here and we'll be here going forward, but again, it's just one piece of what we're doing.

Kate McShane {BIO 7542899 <GO>}

Okay. So going from membership to Sam's, since that is our membership model, it's displayed a lot of momentum over the past few years. Trends have remained really strong. You just announced a leadership change there. Can you talk a little bit about what you're seeing in that business? Why you think the sustainability of demand is sustaining and why is now the right time to open new clubs?

Doug McMillon {BIO 3063017 <GO>}

The momentum of Sam's for years now has been so encouraging and I think it's earned. I think environmental things changed, 2021, 2022, there were things that happened that caused that format to do well, but it was more than that. The remodels that were done inside Sam's Club, Bold & Blue [ph], what Kath and the team did was great. It really refreshed that experience. But more importantly, the merchandise got better. What Kath McLay and the team did, Megan Crozier with Member's Mark, private brand has been terrific. Just one out at time, newness, quality, I'm addicted to some Sam's Club membership Member's Mark items and I'll always buy membership because I want the cashews, I want the mixed nuts, I want fresh squeezed orange juice, I want the prepared meals, there are things that we just have to have as a family and I think that's been happening with members more broadly. And we did take a pause, opening new units in Walmart US and in Sam's and focused on e-commerce and some other things. During that period of time, there has been some relocation in the country, there are opportunities in places like

Texas and Florida, where we can easily see that we need buildings and so we're excited about the opportunity to have a number of new units go in in addition to the investments we're making in remodels and automation.

Kate McShane {BIO 7542899 <GO>}

And is that new units both in Sam's Club and Walmart US?

Doug McMillon {BIO 3063017 <GO>}

I think we've announced Sam's Club openings. I'm trying not to make any announcements here today.

Kate McShane {BIO 7542899 <GO>}

Okay, I'm sorry.

Doug McMillon {BIO 3063017 <GO>}

But what I just said applies that geographically there are opportunities for new buildings.

Kate McShane {BIO 7542899 <GO>}

Okay, thank you. And then, we want to ask about international. Walmart divested a couple of international regions a few years ago, but it's been displaying growth in those segments that you have retained. Can you talk about what you're seeing in your core markets and how your alternative value streams applied to this segment, you touched on that a little bit, but?

Doug McMillon {BIO 3063017 <GO>}

Yeah. I've been traveling, I was saying to Kate earlier, internationally, lately, I've been in Canada and Chile, and I've been talking to the team in Mexico, went to India not too long ago and more than ever we are working on very common strategies. And when you hear our teams talk from around the world, they say the same things and generally the same order, which unlocks opportunities to create tech that applies everywhere faster and better, particularly the Americas, Canada, the U.S., Mexico, down to Chile, the omni strategy, the components of it. Stores, clubs, a brick-and-mortar business, and eCommerce business, 1P, 3P, marketplace, advertising business, fulfillment services, it's the same stuff. And so whereas in the past, we grew through acquisitions and we picked up all these different tech stacks. We've been working for years to create commonality there that will enable us to take things like Project Glass in the U.S. when we launched our new app and we put together grocery pickup and the broader assortment on the Blue app, that piece of tech applies in all these other countries. So we're getting faster at scaling those across. India is a little different. China is a little different, but the countries I just mentioned, can have a ton of commonality. So there's more opportunity for innovation, speed, productivity by leveraging those things one time across.

So I was responsible for International when we were in all those other markets and what Judith McKenna has done with international last six years has been fantastic. And we kind of know that there is power and focus and then if you exit some markets that it will show up, it's a little hard to model sometimes, like how much would it really help you. But I can tell you now having look back at exiting those markets has really helped us. And we're in a great set of markets right now with more upside in terms of growth. The profile of our International business on the top-line and bottom-line looks really different than it did a few years ago and that tech leverage is going to be part of the secret sauce to achieving all of that and helping the U.S. businesses at the same time.

Kate McShane {BIO 7542899 <GO>}

Okay. We're at the point where we're asking four questions to all the companies that present here. So we'll just quickly go through it. We already talked about health of the consumer a little bit, but into '24 we're wondering if you think the consumer will be facing more headwinds or less versus '23.

Doug McMillon {BIO 3063017 <GO>}

Can I say, about the same?

Kate McShane {BIO 7542899 <GO>}

Sure, that's the choice too.

Doug McMillon {BIO 3063017 <GO>}

Is that an option?

Kate McShane {BIO 7542899 <GO>}

Yeah.

Doug McMillon {BIO 3063017 <GO>}

I think I said it earlier, but it felt to me like because of inflation that things were going to be tougher this year than they had been. And so I don't know exactly what's going to happen 12 months from now, but it feels like because of employment wages, some disinflation, that things kind of hang in where they are. And for Walmart, we actually don't worry that much about whether the economy grows 3%, 2%, shrinks 1%, if people are more value-conscious, they come our way, even better to pay more money, will drive more sales, so we have a bit of a hedge against that. And we're just focused on executing our plan and don't worry too much about what happens broadly with the consumer.

Kate McShane {BIO 7542899 <GO>}

Okay. And the part B of that question which you kind of just touched on too is the potential impact from trade-up or trade-down in '24 versus what you saw in '23.

Doug McMillon {BIO 3063017 <GO>}

Again, I think it's probably about the same as we're seeing right now. The more disinflation happens in categories like dry grocery and consumables, the more discretionary income they have to buy general merchandise, so we may see mix shifts, but the spend level kind of things into where it is I would expect the behavior to be about what it is now. And I think holiday is going to be pretty good. So I don't go into next year feeling too pessimistic.

Kate McShane {BIO 7542899 <GO>}

Okay. And share of wallet, we talked about maybe the trade-off between consumables and discretionary, but do you have any views on the role of goods just versus services, maybe in terms of prioritization of what you would expect to see in '24?

Doug McMillon {BIO 3063017 <GO>}

They want all that, don't they? I mean, everybody wanted to take a vacation and get out and travel and they have and they are, that probably continues, and on the good side as pricing moves around, I think there'll be enough dollars to be able to get the mix that we want to get.

Kate McShane {BIO 7542899 <GO>}

Okay, great. Pricing too, we've kind of touched upon, thinking about pricing in 2024, safe to say you think prices will be lower next year versus this year.

Doug McMillon {BIO 3063017 <GO>}

Slightly lower than a year ago, higher than two years ago, and our price gaps are in a healthy place enabling us to grow and we're going to maintain those price gaps as suppliers take their cost down, we'll try to quickly pass it onto customers and members. But I think the suppliers are going to be able to do that. I think their cost structure is changing. Many of them are wanting unit volume now and that's going to help us drive demand.

Kate McShane {BIO 7542899 <GO>}

Okay. And then the last question is on destocking. Obviously, there has been a period here where...

Doug McMillon {BIO 3063017 <GO>}

That's a new word for me, relatively, recently like what does that mean, by the (inaudible) inventory, yeah, that's how we should do.

Kate McShane {BIO 7542899 <GO>}

So there is in that period where you worked to some inventory down, where would you say you are in that process? Are you more trying to be in a position to chase going into holiday in next year? How should we think about that?

Doug McMillon {BIO 3063017 <GO>}

Right now we're in right spot. I think we're in good shape. The adjustment that we needed to make when things change dramatically, honest, last year got made and got made pretty quickly, so we are item and category at a time, thoughtful about the level of aggression. So I was walking with merchants recently and we were going through the holiday assortment and there are places where our buyers because of their experience and the data they have they have a desire to go big and will buy an item heavy and be aggressive and bullish. And there are other places where we're just letting the replenishment model work and I think that's how it should be. So in terms of our inventory, it's been coming down. We're in good shape, where our in-stocks improved, and I think we're appropriately aggressive in the seasonal categories.

Kate McShane {BIO 7542899 <GO>}

Okay. That's all the questions I have, so thank you so much.

Doug McMillon {BIO 3063017 <GO>}

Thanks for having me.

Kate McShane {BIO 7542899 <GO>}

Thanks for joining us.