Evercore ISI 3rd Annual Consumer and Retail Conference

Company Participants

- John David Rainey, Executive Vice President and Chief Financial Officer
- Stephanie Schiller Wissink, Senior Vice President & Head of Investor Relations

Other Participants

- Greg Melich, Evercore ISI

Presentation

Greg Melich {BIO 1507344 <GO>}

Good morning, everyone. I'm Greg Melich. I cover the retail Broadlines & Hardlines here at Evercore ISI. It's my pleasure to have with us today, John David Rainey, the Chief Financial Officer of Walmart, an exciting almost first year under his belt.

And John David, it's a pleasure to have you with us. Thanks for coming, and I'll have you introduce the team.

John David Rainey {BIO 17599063 <GO>}

Yes. Greg, thanks for hosting us. It's a pleasure to have the opportunity to speak with this audience. With me today, I've also got Kary and Steph, and so they'll join me in answering some of your questions. We're really looking forward to it.

Questions And Answers

Q - Greg Melich {BIO 1507344 <GO>}

(Question And Answer)

That's great. So, I'll kick right off on a strategic update. Walmart has undergone a lot of portfolio shifts in terms of international businesses and even different capabilities that they bought or gotten rid of divested. I'd just love an update now on where we are in terms of the portfolio of the business both geographically and by function.

A - John David Rainey {BIO 17599063 <GO>}

Sure. Happy to do that. International has gotten a little more focus since we talked about it at our Investor Day a couple of months ago and for good reason. It's an area of a lot of excitement. India gets a lot of attention with what's happening there with

Flipkart and PhonePe. It's not crazy, Greg, to think that both those businesses could be $100 billion businesses in the future, and so it's quite exciting there.

But our international portfolio is much more than that, when you think about the rest of our footprint. And I would say, we're pretty comfortable with where we are right now. There's not necessarily a region of the world, where we think that we need to be where we're not. And so, I think the international portfolio is probably pretty stable at the moment.

We get asked a lot of questions about this, particularly when people try to derive the return on invested capital for this portfolio. But there's a couple of things that are probably worth noting. It's a little into the weeds, but if you'll indulge me on this. But with respect to some of our investments internationally, like JD.com and some of these others, if you think about the equation of return on invested capital and our accounting for that, we actually have nothing in the numerator, but a number in the denominator, because that is just mark-to-market at each period.

By the same token, acquisitions that we made in the past, like Asda, when because we segment report at an international level, we still carry the goodwill from that, even though we no longer have that entity. And so, our return on capital in the international entity is actually quite a bit higher than what one can surmise by looking from the outside in. And so, we talked at our Investor Day about this plan that we have over the next several years of growing operating income faster than sales.

Well, international is a big component of that. In fact, we expect both on a sales basis as well as operating income basis, the international portfolio to do better than the rest of the enterprise.

Q - Greg Melich {BIO 1507344 <GO>}

Interesting. And I guess maybe a same question then in regards to the mix of the business. You've talked about the flywheel and those, whether it's an advertising business or 3P marketplace. Could you help us sort of level set, where we are now in terms of that and getting those back to profitability and driving increased returns?

A - John David Rainey {BIO 17599063 <GO>}

Yes, happy to. In the U.S., I feel like we're beginning to hit our stride in some of these initiatives that go beyond retail. Things like advertising, things like fulfillment services, data ventures. And depending upon what region of the world, we have advanced at different paces. So, if you just think of e-commerce broadly, in China, roughly half of our business is e-commerce. And so, there's a good balance between brick-and-mortar and e-commerce. India, obviously, is almost entirely a digital business.

But when you think of areas like Canada or Mexico or Chile, those are areas that I think we can continue to build out some of these -- this other suite of services that include the things that I mentioned around these digital services, like advertising, fulfillment services. We've made great progress with what we're doing in Mexico, but I think we've got more to go. And so, it's more of a continuation of what we talked about in the U.S. with different levels of advancement.

Q - Greg Melich {BIO 1507344 <GO>}

Got it. So, maybe then bringing it back home a little bit, where are we? What's the bigger opportunity? Is it in marketplace, is it in fulfillment, is it in media, if you look at these, the new businesses domestically?

A - John David Rainey {BIO 17599063 <GO>}

Well, they're all interdependent and we won't be able to do any one of them in isolation without being really good at the others. So, I think, it starts with the value proposition that we provide around convenience and what that does for our customers, as we move more into the channels that are responding to the ways in which they want to shop. It gives us the opportunity to go in and advertise to them or for a third-party seller fulfill their -- the sale of that item and delivered it to our customers. They're all very large opportunities.

Advertising is probably the one that gets the most focus. And so, I don't want to talk about that at the expense of the others, but certainly it's a big opportunity. When you look at what some of our competitors are doing in terms of their advertising dollars relative to their GMV and then you look at Walmart, you would argue that we're way underpenetrated. But I think the important thing for us, if you think about any digital business, the challenge is scale and scaling those opportunities out. Well, we're starting today with scale. We've got hundreds of millions of customers that come to Walmart each week and so, if we can leverage that with these digital opportunities, it gives us a real advantage.

Q - Greg Melich {BIO 1507344 <GO>}

Are there any other capabilities that you need or we sort of piloted and tested the capabilities, so that now you can scale the back-end, whether it be from innovation, logistics, et cetera?

A - John David Rainey {BIO 17599063 <GO>}

At a macro level, I don't feel like there's anything that we're missing. At a micro level, I think we can get a lot better at some of these capabilities, understanding our customers, understanding what creates great buying experiences for them, where they want to come back with frequency and shop with us in multiple channels. And so, this is part of building that muscle. We are less advanced in some of the leading companies in the space and so that's what we're doing right now. But that's what excites me about the opportunity that we have in front of us.

Q - Greg Melich {BIO 1507344 <GO>}

Maybe to pivot a little bit and we walked around the world. We got to the U.S. strategic Sam's Club. It's a business that few years ago, we were closing clubs. Now, we're going to start to open clubs. I guess what changed here. Is it inherently lower margin than Walmart U.S. or not? And help us figure it out.

A - John David Rainey {BIO 17599063 <GO>}

The nature of Sam's and the way that we price for our customers, it is a lower margin business. But if you look at the last three years setting aside the last quarter, we've had tremendous growth, double-digit comp growth over the last three years, 12 consecutive quarters. And we're always looking at where we can change our portfolio, but whether it's adding to it or removing from in some cases.

And in the case of Sam's, we identify some good opportunities, where there's a good market fit and a market need. And it gives us the conviction to go out and add 30 stores over the next several years. Sam's in many ways is, and honestly, I think sometimes gets overshadowed from this larger U.S. segment, but there's a ton of exciting things to talk about in Sam's. In particular, what we're doing with the digital engagement of those customers. And one of the things I love to talk about is the Scan and Pay or Scan and Go, where someone can use a mobile device to shop in store, then seamlessly check out and not have to wait in line. What's interesting about that, Greg, is roughly one in four of our transactions is done that way.

And if you step back and you think about that for a second, that's a digital experience in a brick and mortar world, right? There are a few experiences or few other companies I can probably point to that level of penetration in that type of experience. And so, I think, it's really a great example of where we're advancing and where we're following the customer to make sure that we're providing the type of experience that they want.

Q - Greg Melich {BIO 1507344 <GO>}

We actually had Frank Blake at the conference earlier today, and he was talking about that the data the retailers have and how that's so critical, and the ability to use it to drive customer satisfaction. So, maybe to pivot to a little bit more the business today and the top-line drivers, I would say Walmart's traffic, we've seen accelerate to 3% or better with the comps running north of 5%. Could you help us understand what categories are driving that and some of the consumer makeup within that, that's driving that growth?

A - John David Rainey {BIO 17599063 <GO>}

Sure. Well, we're mostly benefiting from higher growth in grocery right now, food and consumables. And as customers' wallets are being pinched, you certainly see them have more discretion with some of these larger ticket items. And they're looking for value, value and convenience. And so we've seen share gains, most notably in grocery. And when you think about the income demographics that we're seeing that in, it's pretty dispersed across the three income tiers that we follow.

Earlier, in the -- going back last year, when we were seeing higher inflation, it was more skewed to the higher income groups. But I think more recently, it's been more evenly dispersed among all the income groups. But an important thing here, Greg, is that this is not just about value. This is also about convenience. And as we continue to see robust growth in things like delivery from store or people buying something online and picking it up in store, we're providing convenience to customers.

And I think very importantly, if you contrast that to a lot of other trends that we saw throughout the pandemic, some of those trends for good reason, like went up during the pandemic, but then reverted back to trend line. This is an area of our business and specifically what I'm talking about is the grocery delivery or buying online and picking up store or picking it up in store. It's continued to go up into the right throughout the pandemic and then after it.

So, one of the things we look at is the weekly average customer count of our customers. And in the last quarter, we talked about that being 40% up year-over-year. Well, it's been that way for several quarters. If you go back four years ago, this has been a consistent trend up into the right and so I think it really shows that, this isn't much about convenience, is it is about value.

Q - Greg Melich {BIO 1507344 <GO>}

Interesting. So, maybe to follow up on the value side of that and we'll get to convenience. How would you frame your price gaps today versus 12 months ago or for pre-COVID versus the competition?

A - John David Rainey {BIO 17599063 <GO>}

We're comfortable with our price gaps today. And I think that's been the case for the last three, maybe four quarters. And certainly, if you go back multiple years ago, I think, there was a recognition that we needed to invest in that area. We needed to invest in our pricing. We've done that, but we operate in a dynamic competitive environment. So, we're going to continue to do, what's best for our customers, do what's best for Walmart. So, that may take changes from time to time, but we don't see a period or a step change investment in this area. So, it's something that we look at every Monday morning. We have a meeting, where we're monitoring our prices versus the competition. And as we stand here today, we feel comfortable with where we are.

Q - Greg Melich {BIO 1507344 <GO>}

Got it. And we had the Mission Impossible theme at the Shareholders Day. Maybe you follow up a little bit on that. What can Walmart do to help reduce inflation? And where are we with rollbacks and how -- what can that go to historically in terms of the number across the store and categories?

A - John David Rainey {BIO 17599063 <GO>}

Yes, I'll start here. Maybe, Steph, you might want to jump in on the rollback piece. But we're working, we recognize, first of all, like the headline inflation numbers are coming down because we're lapping higher prices year-over-year, but prices are still high. If you're a consumer and you're going to fill up a basket with groceries of food, it's still roughly 20% higher than it was two years ago.

Our mission is to provide the very best pricing for our customers that we can. So, we work with our suppliers to try to make that happen. But we also -- we've got a big private brand business with Walmart U.S., roughly 20%, a little bit ahead of that, greater than 20% of our sales are in private brand items. And Sam's, it's closer to 30%. So, this is a good vehicle to be able to provide value to our customers.

Steph, do you want to talk a little bit about, what we're doing on rollbacks?

A - Stephanie Schiller Wissink {BIO 17692025 <GO>}

Yes. I think John David's point that we're working very closely with our suppliers and our vendors, particularly in dry grocery, but across the overall grocery and consumables basket, to be very directed about how we use rollback dollars. And we're concentrating those around major events, where we know the consumer is looking to us to fight inflation even harder for them.

And if you recall even last fall, we started this campaign, where we would effectively digest inflation for the consumer. So, Thanksgiving meal at last year's price or a holiday basket at last year's value, we carried that all the way through our spring marketing campaign and it's proven to be really effective for us, not only in driving customer engagement, but also reinforcing our position.

And I think we're gaining some goodwill among consumers right now, in addition to overall working very closely with our suppliers to make sure that their dollars are the most effective for them to drive the volume they need as well.

So, it's a continuation of what we've been doing and what's been working, but you're going to see more of that, as we get into the back half of the year. Back to school is a really important point for us to reinforce that value proposition, and then you'll see that continue into the fall and holiday season.

Q - Greg Melich {BIO 1507344 <GO>}

Just to maybe frame a little bit, I think, I heard the number a few weeks ago, when I was out there that we have hundreds of rollbacks now. I think they're typically what 90 days and then. But in the past, I remember there being thousands of Walmart rollbacks at other periods of time. Is that the kind of magnitude that could increase over the next few months?

A - Stephanie Schiller Wissink {BIO 17692025 <GO>}

Yes. I think what John Furner said last -- a couple weeks ago at our shareholders event is that you could see a doubling into the back half, but I don't know that I would put a 10x multiplier on it.

Q - Greg Melich {BIO 1507344 <GO>}

Okay. So, that's definitely the direction I guess. Maybe to pivot a little bit, John David, you mentioned before its value, but it's also convenience, right. I thought one of the things we saw recently was that the pickup 2.0, also with delivery, which you mentioned, and just follow up with more on where you're really getting traction with those initiatives.

A - John David Rainey {BIO 17599063 <GO>}

Yes. Well, a lot of what we're doing there is also automating that supply chain, whether it's the automated storage and retrieval in our fulfillment centers or what we're doing in our stores and these micro fulfillment centers that's making it a lot more efficient for us. And enabling us to better serve our customers, reduce wait times, have more accuracy in terms of the items that we're picking for that basket, because we're continuing to see consumer behavior shift in that direction, where they recognize that, it is a very convenient process.

But moreover, I think, if you are a consumer probably like I was, and prior to the pandemic, you probably didn't think about online grocery or grocery delivery, because you were concerned about the quality of the goods that you were going to get, whether it was the wilted lettuce or the hard avocados, you want to make sure that you have the ability to do that. As customers go through that experience and they have a very good experience, they're much more likely to come back.

And what's important for us is, we think about the expansion of the portfolio of products that we sell, customers get used to doing that, then they're more likely to add that general merchandise item that they can throw into that basket, have it delivered at their house or pick it up at the store. And so, convenience is a really important part of where we're going here. I think importantly, when we look at or we survey the mindshare scores from our consumers, we're rated right now for convenience almost as high as value. We've never been there historically. And so, I think it suggests, Greg, that what we're doing is working and it's resonating with customers. And we want to continue to do that going forward.

Q - Greg Melich {BIO 1507344 <GO>}

And could you remind us the number of stores that are getting the remodel this year to and I'll throw out the 20% number, I think we heard in some New Jersey stores, but feel free to dial that back if you want and update us on the store rollout.

A - John David Rainey {BIO 17599063 <GO>}

We're really excited about a lot of these remodels that we're doing. What is the total number that we have; 300. But the number that Greg's referring to is during our Associates Week, it was disclosed that some of these stores are seeing an uplift in sales as much as 20% after we've remodeled them. And you have to experience this for yourself. It really is -- it's a different Walmart, when you go to it with improved waypoint finding, signage, wider aisles, displays around apparel. And it really has a different look and feel as well as additional brands that we haven't traditionally carried. And so, we're quite excited about it.

But to the 20% number, one would expect and we've seen this historically, when you have a remodel, you're going to get a little bit of an uplift in sales and sometimes that abates over time as that newness wears-off. The uplift that we've seen around this is much, much higher than what we traditionally see. We would again expect it to decline over time. I don't expect any of us believe that we're going to have a 20% uplift in sales in perpetuity. But even if it's a fraction of that, this is a highly accretive ROI initiative for us. And so we're quite excited about it. We're pretty early on into this as well. I don't want to overstate this. We've only done a few stores, but the early returns are quite exciting.

Q - Greg Melich {BIO 1507344 <GO>}

Yes. Another, I won't call it the last, it's certainly not least top-line drivers, Walmart+. You talked about delivery. I'd love to -- where does that fit in the realm of things you're doing to build that loyalty and traffic, particularly with a new customer? I mean, our survey work suggests you got around 12 million members and when we back out some of your numbers, feel free to update that or critique it. But fundamentally, where are we on Walmart+?

A - John David Rainey {BIO 17599063 <GO>}

Yes. So, I think Walmart+, we're in the beginning stages of this, quite excited. And what's really interesting to me about this, Greg, is the group of customers that we see this as, it's a more -- it's a younger, tends to be a little more fluent, more tech savvy customer that again really values convenience. And if you think going back to this convenience notion, that matters to people irrespective of your income level.

And when you look at like grocery pickup as an example, roughly 50% of our Walmart+ members come through that channel or grocery delivery. And so, it's someone that really values the utility of that membership and what it can provide. But I think very importantly for us, it allows us to have more digital engagement with that customer. So, we better understand them and can tailor our offerings that are most relevant to them versus trying to guess and pick and choose certain things that are really based upon more macro level customer stats.

And so, we want to continue to do this, we want to continue to provide value and utility. I think importantly, we need to get better at some of the things that we provide here. Like even if you think about one-day delivery or two-day delivery, or in some cases, we may have to cancel an order, like we have room for improvement there. But these are all things that we're working on and making great progress.

A - Stephanie Schiller Wissink {BIO 17692025 <GO>}

Greg, let me just add to that, just as a follow-up from our associate event. One of the things we're doing uniquely with Walmart+ is, we're co-creating this experience with our customer. So, there's a very strong feedback loop embedded in the development of Walmart+ as a platform. John David's spot on. The value equation is very clear from an economic perspective. The conveniences are increasingly becoming clear. But even going into desirability and help me live better, the other side of our mission, right, save money and live better. So, you're seeing value added to the Walmart+ platform based on the feedback loop we're getting from our customers going out to the market and finding things that help them live better and making that available as part of their overall plus experience.

A - John David Rainey {BIO 17599063 <GO>}

Looking at the CLV or the customer lifetime value of a Walmart+ member, it is appreciably higher than someone that doesn't engage with us this way or is not availing themselves of that membership. They tend to have -- they spend more with this and they tend to shop more frequently. And so, it's something clearly, we want to have more of our customers take advantage of, because of the benefits that we see to Walmart.

Q - Greg Melich {BIO 1507344 <GO>}

Is the lift 50% or does it double? Any --

A - John David Rainey {BIO 17599063 <GO>}

I'm not disclosing the number.

Q - Greg Melich {BIO 1507344 <GO>}

Okay.

A - John David Rainey {BIO 17599063 <GO>}

But I do someway describe it as appreciably higher. We're not talking $10 or $50. It's much higher with that customer.

Q - Greg Melich {BIO 1507344 <GO>}

Got it. Well, maybe, I think, in our last 10, 15 minutes, I want to get to some of the fun stuff like margins. It's great to drive the top-line in the traffic, but it's also good to make more money doing it. So, could you just get in some of the drivers of the margin expansion that you've talked about that you can get back to the goal of growing EBIT faster than sales?

A - John David Rainey {BIO 17599063 <GO>}

The margin expansion that we talked about and we really, I think, drilled in on this at our Investor Day, where we talked about growing margin much faster than sales, it's a result of a number of things. But fundamentally, the mix of our business is changing.

If you think about a 4% or 5% margin retail business, which is growing at a low single-digit rate and then you combine that with these faster growing elements of our business like advertising, like fulfillment services, like data ventures. And I'm not even talking about like what's going on with Flipkart and PhonePe and some of these other entities. These are all things that are improving their margins and have higher margins at a much greater rate and growing faster. So, the pure mix of our business is changing. So, that's one element of that.

The second piece of this is moving more into GM. By moving into e-commerce channels and having a marketplace and third-party sellers, it allows us to provide assortment of merchandise that we haven't historically to customers. And we see that the customers that are coming there are buying more GM. And so that tends to carry a higher margin in some of our food and grocery.

The third area, Greg, really relates to the pure unit economics of what we control in delivering these services and goods to customers. And supply chain is, I think, the best example to point to right there. We're making a tremendous investment in our supply chain. You've got the opportunity to see some of this. You mentioned that. But the unit economics around fulfillment will improve by roughly 20%. It will be 20% lower, rather, I should say, in five years, when we complete this.

And in the next five years or three years, I think it is, we're going to have roughly 65% of our stores that are served by automation. And so, this provides a better experience, more integrity to the experience with our customers, also lowers our unit costs. And so, it's expanding more into GM, it's having these other businesses grow faster, and then improving the unit economics of the services that we provide today.

Q - Greg Melich {BIO 1507344 <GO>}

So, if I was thinking about a unit economics standpoint over that three, four, five years, should I be thinking about supply chain costs coming down 20% if they were 5% of sales, that could be 100 bps of margin? Or can I include some of the store costs as well to maybe even have it be more than 100 bps opportunity? Am I framing that right?

A - John David Rainey {BIO 17599063 <GO>}

The opportunity is in excess of 100 bps, but you're thinking about absolutely the right way. And it applies to both our FCs and DCs, but also the stores themselves. We focus a lot on supply chain technology, but we're implementing technology like our VisBic system back in electronic shelf labels.

So, electronic shelf labels save a ton of hours in a store over the course of a period, like a quarter, because you're not needing to go in and change all of those manually. And all of this, all of this automation really gives us an opportunity to operate much more efficiently and allow our associates to do what they do best, and that's serve our customer.

A - Stephanie Schiller Wissink {BIO 17692025 <GO>}

And Greg, maybe just to finalize that point on associates, our expectation is that our population of associates would remain relatively flat over the next several years. So, we don't expect to see a drawdown in the number of people, but it's redeploying each individual person to do different jobs and upskilling a good majority of our workforce into places that they're serving the customer or more close in proximity to the customer or doing things within the automation sequence, where they're serving and contributing to the overall technology. So, that a real good opportunity for our associates as well and not expecting to have major changes in our overall headcount.

Q - Greg Melich {BIO 1507344 <GO>}

Hold on and I --

A - John David Rainey {BIO 17599063 <GO>}

Go ahead. I'm sorry, Greg.

Q - Greg Melich {BIO 1507344 <GO>}

I guess what I would say is the trend, my next question is going to be basically that, which is that, you've invested a lot in labor over the last few years. I think wages have been up probably low double digits a few years ago and probably up mid-singles this year. Is that moderates back to something more normal, the way here is really to get more productivity out of the labor, is that what I'm--?

A - John David Rainey {BIO 17599063 <GO>}

That's true. And to restate what Steph said slightly differently, we believe we can grow into this. And our labor, we feel comfortable with where we are today, whether it's our average wage or our starting wage. And the wages for our associates have increased tremendously over whether you look at a three-year period or five-year period.

And so, we definitely want to continue to pay our associates appropriately, but it's not just about an average hourly wage. It's all -- we view this as careers, like if you just take a stat like promotions, 88% of the promotions or positions, I should say that have been filled at the store above a start or an entry-level have been filled by people that are Walmart associates. So, we're not going out and hiring someone off the street necessarily. We're giving someone the opportunity to advance. And so that's -- I think that's really important, as people think about their own wealth creation and career growth at Walmart.

But I want to go back to this point that you mentioned around margin, because what we said at Investor Day is that, we expect over the next several years that on average sales will grow about 4%. Some years it may be more, some years it may be less, but on average about 4%. And we said that operating income should grow faster than that. But very clearly, like I'm not talking about like 5%. If all we do is 5%, I'll be disappointed. And so we showed this range of outcomes, I think, kind of cleverly in a shaded graph here, but upwards of almost 8%.

And so, we think there's a tremendous opportunity if we execute on the initiatives that we control to dramatically change the margin profile of our company. And what that really translates into is increased free cash flow, better profits, and then you get into capital allocation, and so it's a big opportunity for Walmart going forward.

Q - Greg Melich {BIO 1507344 <GO>}

That's a great way to tie it together. I do -- I want to make sure that we didn't leave out those, that business mix part that you talked about at the beginning. What is a reasonable goal for things like the media business? Do I look at it as a percentage of sales -- of digital sales? Or how do we even frame what the opportunity is there?

A - John David Rainey {BIO 17599063 <GO>}

The way that we look at it internally, and I think the external metrics around this as well, is looking at it as a percent of GMV, but we call it roughly sales today. And if you look at what some of our competitors do or maybe what best-in-class is, that approach is 10% for some people. But that's also dependent, Greg, upon the types of items that you're selling. So, you'll see more advertising as it relates to GM than you will food. You are going to, it's easier to attract the advertising dollars for a pair of sneakers than it is a head of Broccoli.

And so, if you were to take that 9% or 10%, which is kind of the high watermark in the industry for people like us, and normalize that for our mix of business, that actually translates into call it roughly 6 and being using a little bit crude math here, but roughly 6%, 7% GMV. And so, that's an aspiration for us. If we did that, that would put us in the top 10 probably advertisers in the U.S. in the next five years. And so, it's a big opportunity.

Q - Greg Melich {BIO 1507344 <GO>}

Is there an opportunity beyond just product sales and vendors that you might already be working with? And maybe other, I'm just thinking examples like would Marriott Hotels want to advertise with you knowing that somebody has been looking at luggage?

A - John David Rainey {BIO 17599063 <GO>}

Yes, absolutely. But I -- and I think that's a not insignificant opportunity at all. But I think very importantly, we want to make sure that we advertise in a way that provides a better experience for our customers. We don't want to over-rotate here and just try to monetize advertising dollars and throw a bunch of stuff and offers in front of our customers that aren't relevant to them.

And so, we're always going to keep our focus and our eye on our mission, which is helping our customers, save money and live better. And so, we're going to be probably a little more -- use a little more discretion in certain areas around advertising. But in your example, if that's relevant to that customer, we believe that that's something that we want -- that they would want, we would absolutely consider something like that.

Q - Greg Melich {BIO 1507344 <GO>}

Got it. So, you don't want to go crazy, whether it's a slippery slope, but if it's targeted, it makes sense.

A - John David Rainey {BIO 17599063 <GO>}

Exactly.

Q - Greg Melich {BIO 1507344 <GO>}

Great. So, maybe in the last few minutes, got to get -- we did margins, I want to make sure we get to returns and balance sheet and cash flow and all that good stuff. So, CapEx is going up. I think you guys have mentioned maybe close to $20 billion, no matter how you framed it. When do we get that ROI inflection?

A - John David Rainey {BIO 17599063 <GO>}

Yes. So, let me start with the way that we view capital allocation is every dollar has to compete for all the alternatives that are out there. And right now, we believe the single best investment is investing in ourselves in some of the CapEx, because of the high ROI around that. And what we've stated there is despite a more elevated level of CapEx, we believe that our ROI can go up every year. And to me, that's a good governor or guardrail to make sure that we're not telling the investment community, we promise or just wait, we're going to spend all this money and this will come several years later.

We want to demonstrate that we can invest in our business, while seeing our return on investment go up each year. It'll go up a little bit this year. It's going to go up a little bit more than that the year after that, more the year after that based upon the trajectory of the investment that we're making.

But that said, we believe it's important to be balanced in capital allocation and that includes returning cash to shareholders through the form of share repurchases and dividends. And we're going to be aggressive, where it's appropriate. If we think our stock is undervalued, you'll see us be more opportunistic. But we believe that it's always appropriate to return cash to shareholders through share repurchases.

When we look at our multi-year plan, our five-year plan and the economics around that, that should drive share gains much greater than what we see today. And so, we're investing for the long term here. We're thinking about this in the same way that any investor would.

We also would aspire to continue to increase our dividend. We are a dividend aristocrat. We've been increasing our dividend for a number of years. And at some point in the future, we'd be able to maybe hope to have a step change, where we increase it even more to perhaps have a higher payout ratio than what we do today. But I think it's important that we demonstrate that, that comes with increasing margins, increasing free cash flow before we do that.

Q - Greg Melich {BIO 1507344 <GO>}

And when you -- you talk about payout ratios, is at a percentage of prior year earnings or how would you think about it?

A - John David Rainey {BIO 17599063 <GO>}

Prior year earnings, and if you look historically, go back, 8 or 10 years, that's vacillated or been in a range of call it mid-30s to mid-40s. And that's probably what's been appropriate for our business at that period of time. We don't really have a targeted payout ratio as a policy, I should say. We have something we targeted internally, but we don't have a policy around that. But this is an opportunity for us in the future. If we want to change that and be -- send a little different message to the street around how we're thinking about that dividend.

Q - Greg Melich {BIO 1507344 <GO>}

And maybe the last part of that question is the, what's the optimal leverage ratio? I mean obviously a lot of changes in rates, you own a lot of your real estate, fortress balance sheet, but is there a number of debt-to-EBITDA that you target or, yes?

A - John David Rainey {BIO 17599063 <GO>}

Yes. We generally target a 2x leverage ratio, AA credit rating that provides us the most flexibility, whether with respect to using that capital, also considering things like commercial paper. But I think importantly for us, like, we have a tremendous amount of opportunities, when we think about capital allocation. And we're always going to be looking at this through the lens of what creates the most value for shareholders.

If you look at our leverage ratio today and you were to map out or graph out like, where you get to the lowest weighted average cost of capital, it would suggest that we could lower it marginally, but we lose some flexibility by doing that. And so, we really like where we are with roughly a 2x leverage ratio and AA credit rating.

Q - Greg Melich {BIO 1507344 <GO>}

It makes a lot of sense. And I think our time has come on to a close. So, John David, I want to appreciate your time. We got through a lot in 35 minutes. Kary and Steph, I'll be annoying you to figure out what remodeled store we should tour at the summit next year. Thank you for joining us and have a great rest of summer.

A - John David Rainey {BIO 17599063 <GO>}

Okay. Thank you, Greg. Appreciate it. Bye.