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Walmart, Inc. (WMT)

Q1 2023 Earnings Call

CORPORATE PARTICIPANTS

Daniel Binder
Senior Vice President, Corporate & Enterprise FP&A and Investor Relations, Walmart, Inc.

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

Kathryn J. McLay
President and Chief Executive Officer, Sam's Club, Walmart, Inc.

Judith McKenna
President & Chief Executive Officer-Walmart International, Walmart, Inc.

OTHER PARTICIPANTS

Simeon Ari Gutman
Analyst, Morgan Stanley & Co. LLC

Karen Short
Analyst, Barclays Capital, Inc.

Robert Drbul
Analyst, Guggenheim Securities LLC

Stephanie Wissink
Analyst, Jefferies LLC

Gregory Melich
Analyst, Evercore ISI

Michael Lasser
Analyst, UBS Securities LLC

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.

Kate McShane
Analyst, Goldman Sachs & Co. LLC

Christopher Horvers
Analyst, JPMorgan Securities LLC

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Oliver Chen
Analyst, Cowen & Company

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Michael Baker
Analyst, D.A. Davidson & Co.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Chuck Grom
Analyst, Gordon Haskett Research Advisors

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Ben Bienvenu
Analyst, Stephens, Inc.

Scot Ciccarelli
Analyst, Truist Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Greetings. Welcome to Walmart's Fiscal Year 2023 First Quarter Earnings Call. At this time, all participants are in listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] Please note, this conference is being recorded.

I'll now turn the conference over to Dan Binder, Senior Vice President, Investor Relations. Dan, you may begin.

Daniel Binder

Senior Vice President, Corporate & Enterprise FP&A and Investor Relations, Walmart, Inc.

Thank you, Rob. Good morning, and welcome to Walmart's first quarter fiscal 2023 earnings call. I'm joined by members of our executive team, including Doug McMillon, Walmart's President and CEO; Brett Biggs, Executive Vice President and Chief Financial Officer; John Furner, President and CEO of Walmart US; Judith McKenna, President and CEO of Walmart International; and Kat McLay, President and CEO of Sam's Club. In a few moments, Doug and Brett will provide you an update on the business and discuss first quarter results. That will be followed by our question-and-answer session.

Before I turn the call over to Doug, let me remind you that today's call is being recorded and will include forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from these statements. These risks and uncertainties include, but are not limited to, the factors identified in our filings with the SEC.

Please review our press release and accompanying slide presentation for a cautionary statement regarding forward-looking statements as well as our entire Safe Harbor statement and non-GAAP reconciliations on our website at stock.walmart.com.

It is now my pleasure to turn the call over to Doug McMillon.

C. Douglas McMillon

President, Chief Executive Officer & Director, Walmart, Inc.

Good morning. Thank you for joining us to hear about our results. We had a good quarter from a top-line point of view. Sales for the period were ahead of what we expected across all segments, and we're pleased with the momentum we see so far in Q2. The bottom line was below our expectations due primarily to three areas that negatively affected operating income in our US businesses, both in Walmart and Sam's Club. Each of these items represents about one-third of our overall profit miss.

The first item is wage expense. As the Omicron variant case count declined rapidly in the first half of the quarter, more of our associates that were out on COVID leave came back to work faster than we expected. We hired more associates at the end of last year to cover for those on leave, so we ended up with weeks of overstaffing. That issue was resolved during the quarter primarily through attrition.

The second item relates to our general merchandise inventory level primarily in Walmart US. GM was a lower percentage of total sales in Q1 resulting in an unfavorable gross margin mix. We also had higher costs for containers and storage, and we've taken and are taking steps to contain those cost pressures to the first half of this year. The third item is related to fuel costs and our supply chain. So those are the three items. And now, I'll share more detail on each to help provide clarity.

As for wages and staffing in the US, we had nearly all associates on COVID leave return in February. We expected the Omicron curve to be steep on the back side, but given that we needed more associates to cover in January, it just took some time over March and April to get wage costs in line with sales. We're now staffed in a way that supports our top-line performance.

As it relates to Walmart US general merchandise sales, we knew that we were up against stimulus dollars from last year, but the rate of inflation in food pulled more dollars away from GM than we expected as customers needed to pay for the inflation in food. We like the fact that our inventory is up because so much of it is needed to be in-stock on our side counters, but a 32% increase is higher than we want. We'll work through most or all of the excess inventory over the next couple of quarters.

We started being aggressive with rollbacks in apparel, for example, during Q1. Even with reduced prices, the apparel margin can still be helpful to our overall mix.

As we managed the quarter, we generally passed on cost increases from suppliers at the category cost of goods level but fuel costs accelerated during the quarter faster than we were able to pass them through, creating a timing issue. Fuel ran over $160 million higher for the quarter in the US than we forecasted. We made progress matching pricing to the increased costs as the quarter progressed, and while we expect some gross margin pressure in Q2, we expect an improvement over Q1.

We're not happy with the profit performance for the quarter, and we've taken action, especially in the latter part of the quarter, on cost negotiations, staffing levels, and pricing, while also managing our price gaps.

While we've experienced high levels of inflation in our international markets over the years, US inflation being this high and moving so quickly both in food and general merchandise is unusual. We'll control what we can control, reduce our inventory level, and keep prices as low as we can, especially on opening price-point food items, while improving our profit performance.

Inflation is playing a role in the top and bottom line, and the pace of change created a timing issue for us in Q1. We're adjusting to the mix change and operational costs. Importantly, we expect the solid top-line performance to continue and we're taking up sales guidance for the year. Customers and members are coming to us for value.

I'd like to highlight our international team and their performance. We had strong top-line performance and managed the quarter very well across the markets. Our biggest international pressure point is related to the COVID lockdowns in China, which created operational and financial pressure. Our teams did a great job of pivoting to serve customers and members through delivery. They stepped-up as stores and clubs closed and demand for delivery spiked. Overall, the international segment had another good quarter.

We're making progress executing our strategy. The flywheel we're building is better for customers and members, and the more diversified approach to profitability is making the company stronger. We're excited about our newer businesses and our plans to automate much of the supply chain. We're committed to our 4% top-line growth and greater than 4% profit growth algorithm. Our strategy and mid- to long-term financial plans support that despite the turbulence we're managing through today.

Globally, we continued to build new, mutually reinforcing businesses. As we grow in areas like Marketplace, that leads to growth in fulfillment services and advertising income. Our B2C relationships lead to complementary B2B relationships, which strengthen our P&L. The number of Marketplace sellers we have continues to grow, and growth in Walmart Connect and Flipkart Ads was strong for the quarter.

Walmart GoLocal continues to add new partners for our delivery platform, and we've now reached more than 1,600 delivery points in the US. We recently increased the Walmart+ benefit for fuel to up to $0.10 and expanded the number of participating fuel locations to more than 14,000 including Exxon and Mobil stations.

Our health and wellness work continues. In the US, we announced an expansion of Walmart Health into Florida with the opening of four new locations and one more on the way.

In India, the launch of Flipkart Health+ following our acquisition of online pharmacy platform, SastaSundar.com, is enabling us to increase access to affordable care in that country. The team recently launched the Flipkart Health+ app, which is available on low bandwidths so it's useable for more people in more cities. And in Canada, we're growing our number of primary care clinics to 87, and in partnership with TELUS Health, we'll launch digital pharmacy services.

We're also making progress with financial services. In India, PhonePe recently processed more than 100 million transactions in a single day. With annualized total payment value of about $770 billion, it's one of the fastest-growing businesses in this space.

I also like what we're doing in Mexico with our digital wallet, Cashi. In the US, through our JV with Ribbit Capital, we completed the acquisitions of two fintech businesses, One Finance and Even, and combined those businesses under the ONE brand. Around the world, we can help our customers and members transact seamlessly, digitally, and help them strengthen their lives financially.

Now, I'll briefly comment on each segment before Brett adds additional detail. In Walmart US, our sales performance was ahead of plan and we continued to gain share in grocery. Inflation is lifting the average ticket and our transaction count in stores went up slightly versus last year. Overall basket size is up as you would expect, but units per basket are down a bit. Price leadership is especially important right now and one-stop shopping becomes more than just convenience when people are paying over $4 a gallon for fuel.

Overall, eCommerce growth increased about 1% for the quarter. We're making progress on the eCommerce experience as in-stock improves and the team continues to improve on the app and site experience and delivery accuracy and speed.

Our eCommerce operations were affected early in the quarter as we lost one of our largest fulfillment centers to a fire which created some cost inefficiencies for us. The buildings were destroyed but thankfully and most importantly, no one was hurt. The loss did put strain on our system, however. The team quickly reacted to utilize our stores and spread volume to our other FCs to fulfill eCommerce orders. I'm proud of the team for moving so quickly to keep orders flowing to our customers.

Moving to Sam's Club US, we continued to drive strong comp sales on a one- and two-year basis with strength across most categories. Transactions were up in Q1, overall membership count continued to grow, Plus member penetration reached another all-time high, and we saw good growth in eCommerce. Profitability was negatively affected by the areas I mentioned earlier.

Walmart International continues to build on the momentum from last year with strong comp sales across markets and strong growth in eCommerce. I visited our teams in stores in Mexico and Canada since the first of the year. The progress they're making on building out our flywheel capabilities is impressive, from financial services and healthcare that I mentioned earlier, to marketplace expansion and advertising, the teams are moving quickly.

I also like the example from Mexico where we have a MXN 200 pesos per month unlimited internet option that's helping customers access the benefits of the digital economy that would otherwise cost them three times that price.

In summary, around the world, we're still living in environments with COVID present and navigating the economic and other impacts to deliver for customers and members. As always, our associates are doing a great job, and we're grateful to them. We continue to change and strengthen our company and position it for a strong future.

Thank you for your interest in our company. We hope to see you at our annual Associate and Shareholder Celebration in a couple of weeks.

As I turn it over to Brett, I want to pause and say a big thank you to him. Brett made significant contributions to our company and all parts of our business for many years. He has represented our associates, our investors, and our company so well. His knowledge, astute judgment, and character have made him a pleasure to work with. Thank you, partner.

With that, I give you Mr. Biggs.

Brett M. Biggs

Chief Financial Officer & Executive Vice President, Walmart, Inc.

Thanks, Doug. In the first quarter, we faced some new challenges as well as some that were more pervasive than anticipated. Of course, we've been in a very fluid environment for more than two years, and I'm proud of the way the company has performed during that time.

Q1 sales were strong across all segments and the strength has continued in the start of Q2, reinforcing Walmart wins with customers in even the most unique environments. The first quarter was one of the most challenging periods yet related to supply chain disruptions, increased costs, and persistently high inflation.

There are some things that were unique to the first quarter like some labor scheduling inefficiency as US associates returned more quickly than expected from COVID-19 leave, and some things that will likely be more persistent than anticipated when we gave guidance at the start of the year.

As Doug mentioned, during the quarter, particularly in the middle of the quarter, we weren't able to fully address or pass along some of the cost increases that impacted profit more than expected. We're now managing those costs and passing them along more effectively.

The costs related to inventory and fuel prices in the US will stretch some into Q2, but the scheduling-related costs have been mitigated. Most of the increased inventory and related costs were related to buying over the past several quarters with a keen focus on in-stock, and now we're in a short period of rightsizing it.

The current sales strength and warmer weather in the US give us confidence in our ability to work through this fairly quickly and strategically.

Our market position is strong, and our business model was built to weather times like this when customers are making more real-time choices. We're there for them and we'll continue to provide great value while managing the business in a way that's also good for shareholders. We'll continue to reduce costs where we can and manage pricing in a way that preserves competitive price gaps, while managing the bottom line and passing on costs where they appear to be less temporary in nature.

Our expectations for the top and bottom line growth algorithm remains structurally unchanged. As we navigate the current environment, we continue to make great progress building our flywheel and executing our long-term strategy. For example, the global advertising business grew over 30% in Q1. I'm excited about what is ahead and what it means for customers as we more actively engage with them in different areas of their lives and deepen those relationships.

Now, let's get into some additional Q1 details. As a reminder, my comments today will exclude the effect of last year's international divestitures.

We delivered strong top-line results in the first quarter, with total constant currency revenue up more than 6% reflecting healthy growth in each segment. Walmart US gained grocery market share and had higher average ticket despite lapping last year's significant benefits from US stimulus. International was led by Mexico and Canada, while Sam's Club US delivered the ninth consecutive quarter of double-digit comp growth, excluding fuel and tobacco.

First quarter gross margin rate decreased 89 basis points versus last year due in part to pressure at Sam's Club from supply chain costs, fuel mix, inflation, and markdowns caused by inventory delays. Walmart US gross margin rate was down 38 basis points with more than 75% of the decline related to higher-than-expected supply chain, fuel, and eCommerce fulfillment costs.

While we did see some supply chain improvement early in the quarter, the war in Ukraine and ongoing COVID impacts in various parts of the world including China led to increased challenges.

While sales were ahead of plan in Q1, the category mix in the US was heavier in food and consumables, as spending shifted somewhat away from more discretionary items including categories impacted by unseasonably cool weather such as apparel, patio furniture, and landscaping supplies. We remain very bullish on our food and consumables business.

Consumers are feeling inflation pressures as evidenced by an increase in grocery private brand penetration. The category mix shift along with increased inventory, some of which was delayed in arriving, led to higher than normal markdowns for general merchandise. In Q1, unexpected markdowns pressured Walmart US gross profit by about $100 million. We expect the inventory position to improve as we go through Q2.

SG&A expenses deleveraged 39 basis points primarily due to increased US wage costs partially offset by lower total COVID costs versus last year. We expected higher labor costs at Walmart US due to the hourly associate wage increase announced last year.

As mentioned, Q1 profit declined more than expected with operating income down 20% and adjusted EPS down 20% to $1.30. Operating cash flow was also lower-than-expected at negative $3.8 billion. This is due to several factors including higher inventory amounts with about half of the increase due to inflation, lower operating income, and the timing of certain payments and payables due to inventory delays. Given our confidence in selling through the inventory, I feel confident about operating cash flow getting back on track as we go through the year.

Now let's discuss segment results. Walmart US comp sales excluding fuel grew 3% and were up 9% on a two-year stack reflecting strong food sales, which were up low-double digits. As mentioned previously, general merchandise sales were softer, but still increased high-single digits on a two-year stack. Transactions were flat versus last year, while average ticket increased 3%. eCommerce sales grew 1% against strong gains last year as customers continue returning to stores.

We're making strong progress in many of our newer higher-margin initiatives. The Walmart Connect advertising business continues to scale as we expand self-serve capabilities and offerings. Our new data monetization business, Walmart Luminate, continues to accelerate with over 75% growth quarter-over-quarter, as more supplier partners collaborate with merchandisers to utilize new customer insights in our platform.

We also continue to expand our Walmart GoLocal delivery as a service business with new partnerships announced during Q1. In addition, we held grand openings of four new Walmart Health centers in Florida and will open another one next month as we continue to expand access to affordable quality care.

ONE, our strategic fintech partnership with Ribbit Capital, closed on the One Finance and Even transactions which sets the foundation for growth. Collectively, these initiatives represent large revenue and profit opportunities over the next several years.

Gross margin pressure and expense deleverage led to a decline in operating income of about 18%. Inventory increased about 33% due to inflation and aggressive inventory buys over the past few quarters.

International sales were strong, up 8% in constant currency, with Mexico and Canada leading the way. eCommerce sales in constant currency grew 22% on top of strong gains last year with growth of 86% on a two-year stack. Comp sales in Mexico increased 9% with strong growth in stores as well as eCommerce sales, which grew nearly 20% in Q1 and 185% on a two-year stack.

In Canada, comp sales were up 7.7%, while in China, growth was slower than expected, but comps still increased more than 4% led by eCommerce growth of nearly 90%.

Flipkart had another good sales quarter with solid trends in monthly active customers and users. We're also pleased with the strong growth of PhonePe with annualized TPV of over $750 billion as the team continues to launch new customer offers such as the recent expansion of insurance offerings to include health, auto, and ATV coverage.

International operating income at constant currency declined nearly 13% primarily due to lower gross profit in China reflecting increased markdowns and higher eCommerce penetration during the quarter, as well as investments in eCommerce across the portfolio.

Sam's Club had another strong sales quarter with comp sales up 10.6% excluding fuel and tobacco, an increase of about 21% on a two-year stack. Transactions increased 10% and ticket was slightly positive. eCommerce sales grew 22%. Membership income was up 10.5% with another record in member counts. Operating income was down 20% as the gross margin pressure I mentioned previously was partially offset by higher membership income, fuel profit, and expense leverage.

Now let's turn to guidance, which will be discussed ex-divestitures. While we don't typically update guidance at the end of Q1, we felt it was appropriate given the current environment and the profit miss in Q1. We're behind for the year, but we're also just one quarter into the year, with time and options in front of us. The team's focus is still on the original profit guidance.

Based on our continuing strong top-line, we feel good about our ability to deliver full year sales growth in excess of our original guidance. We now expect consolidated net sales growth excluding divestitures to be 4.5% to 5%. We expect Walmart US comp sales growth of about 3.5% for the year versus the original guidance of slightly above 3%. However, as a result of the higher than anticipated costs we saw in Q1 and the expectation of some of that to continue, growing operating income at our original guidance more than sales growth is challenging.

We now expect operating income and EPS to be relatively flat year-on-year. As is our usual practice, we'll update you on our progress as we finish Q2.

For Q2, we expect net sales growth of over 5% including comp sales growth of 4% to 5% for Walmart US. As our confidence builds in our ability to manage cost increases more efficiently, operating income and EPS are expected to be flat to slightly up.

In closing, I'm pleased with the top-line momentum we're seeing across the business. While Q1 profit was lower than expected, during this dynamic and challenging environment, I'm proud of how our teams continue to be laser-focused on serving customers and taking care of shareholders.

Now, we'd be happy to open up the call for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we'll now be conducting a question-and-answer session. [Operator Instructions] Thank you. And our first question is from the line of Simeon Gutman with Morgan Stanley. Please proceed with your question.

Simeon Ari Gutman
Analyst, Morgan Stanley & Co. LLC

Q

Good morning, everyone. I have one question and one follow-up. My first question is on the health of the consumer. I'm curious what your assessment is if the consumer is getting marginally weaker, staying about the same? You mentioned there were some mix shifts in your quarter, but you also said that you're adjusting pricing and you raised your sales guidance, so it would seem that maybe the consumer isn't getting weaker?

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

A

Hey, Simeon. This is Doug, and John or Brett may want to add some color too. I think it's important to recognize that there's more than one consumer. And we serve the whole country. I assume you're talking about the US in particular, so we've got a breadth of customers and they behave differently. As we said in our pre-recorded remarks, for some customers, we are seeing some indications of change throughout the quarter but that's not true for all of them.

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

A

Hey, Simeon. Good morning. It's John. Just to reiterate what Doug said, we do serve a wide range of customers and certainly have seen strength in the consumer. We see growth in high-ticket items like game consoles, recently with warmer weather, strength in patio furniture, grills, gardening and hardlines, but we do see some consumers switching.

We see categories like deli, lunch meat, bacon, dairy, where we see customers trading from brands to private brands, so we see both of those things happening at the same time. But as we reported, strong top-line results. We see a wide range of consumer behavior.

Simeon Ari Gutman
Analyst, Morgan Stanley & Co. LLC

Q

And maybe the follow-up regarding the guidance change and what happened in Q1. In Q4, the business created this perception that it was being managed pretty agile. You were able to adapt to higher costs and you raised price. Was it in the first quarter that costs were up too quick, or that you were hesitant to move price to the degree that you did in the fourth quarter? It was just such a divergence from how you managed Q4 to Q1 albeit not that you manage it that finely every quarter, so that's what created the surprise I think to us in the profit miss?

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

A

Yeah, Simeon, it's more about the speed than it is the other issue. Things moved quickly in the back half of the quarter, and as you mentioned, it sometimes creates a timing issue. So life doesn't begin and end with the quarter dates beginning and end, and we'll manage this as we go through the year, but the mindset and the ability to management haven't changed.

Operator: Thank you. [Operator Instructions] The next question will be coming from the line of Karen Short with Barclays.

Karen Short
Analyst, Barclays Capital, Inc.

Q

Hi. Thanks very much. I wanted to just ask a little bit about the inventory and I ask in the context of how much you fully factored in the risk that the consumer further weakens. And therefore, in that context, how much ability going forward do you have to flex the P&L with respect to or manage I guess the P&L with respect to further markdowns, gross margin risk in the US given your high levels of inventory, but also contemplating the risk of further SG&A deleverage if there is more weakening with the consumer? Thanks.

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

A

Hey, Karen. Sure. Hey, Karen, it's John. First, I'll just reiterate strong top-line in the first quarter and then our guidance on top-line would reflect our confidence that there will be strength in the top-line.

As you look at what happened in Q1 specifically, we did take on more inventory but we've seen strength as of recently in general merchandise given the warmer weather. We have a large number of rollbacks that are present right now and the customer is responding to both very well. As I said, we have strength in high-ticket items like durables and hardlines and then we do see some switching.

On inventory in particularly, we're up about 33% and the vast majority of that increase is a reflection of both inflation and inventory positioning that improves availability quarter-to-quarter, which we're happy with. And then we have some inventory, the remaining portion of the increase that we'll have to work through and sell-through over the next couple of quarters.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.
A

And Karen, this is Brett. I feel good about the timeliness of how we're handling inventory with rollbacks, the way we're looking at pricing. As we said in our prepared remarks, I think over the next quarter or two, we'll work our way through this, but I feel good about the way we're going to manage through this.

Operator: Our next question comes from the line of Bob Drbul with Guggenheim. Please proceed with your question.

Robert Drbul
Analyst, Guggenheim Securities LLC
Q

Hey, good morning. And Brett, congratulations. Going to miss you. Thanks for everything.

My question would be, can you talk about just conversations with your vendors given their strong results? Are you leaning in more on negotiations? Can you just sort of help us understand your mindset at this point? Thanks.

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.
A

Hey, Bob. I'll take it. It's John. As we said, we definitely have seen an inventory increase. A large portion of that was planned, but certainly the way we feel about given some of the switching and other things that I mentioned earlier, I mentioned categories like deli, lunch meat, dairy, bacon, where we see switching.

Our team and our suppliers need to do everything we can do to keep costs low so that we could have values for customers that are meaningful. That's the purpose of the company. We're positioned to do well in great economies and economies that aren't as good. So we're going to be positioning ourselves well to take care of our customers going forward and our teams and our suppliers, we both need to do more to help customers out.

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.
A

Thanks, Bob. Appreciate it.

Robert Drbul
Analyst, Guggenheim Securities LLC
Q

Thank you.

Operator: Our next question is from the line of Steph Wissink with Jefferies.

Stephanie Wissink
Analyst, Jefferies LLC
Q

Hi. Good morning, everyone. We have a follow-up question on what you're seeing – or what you have seen throughout the course of the quarter. Any material change in the consumer basket that you think is notable? I know you called out mix shift towards grocery, but any signs that the consumer as the quarter progressed reacted differently than you expected? Thank you.

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

A

Yeah, so on the basket, in the first quarter, we definitely had an impact due to the offsetting of stimulus from last year. We had a very strong quarter last year, one of the strongest quarters we ever had. So we expected an impact in general merchandise as we went into the quarter and we did see increased strengthening in food as the quarter went along, and then late in the quarter, and then to the beginning of the month of May, we've seen strengthening in general merchandise. I think it's a combination of warmer weather across the country and the response to the rollbacks that we put in place.

In terms of the consumer themselves, we've seen strong growth with higher income consumers, middle income, and lower income, but we do see definite strength with high-ticket items as I said with some consumers and others we do see some switching, which would include switching specifically from brands to private brands.

Operator: Thank you. Our next question comes from the line of Greg Melich with Evercore ISI.

Gregory Melich
Analyst, Evercore ISI

Q

Hi, thanks. My question was really about what's driving the basket and working down the inventory. So it's one question. But I guess, if we look at this quarter, is there a way to say how much was inflation and mix? I think you mentioned units were down. Could you give us a number to that? And then really on inventory, should we expect $100 million of markdowns the next couple quarters? How do we think about that cadence?

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

A

Hey, Greg. On the basket, first of all, what we're seeing right now is an increase in traffic and ticket. We did see units per basket slightly lower in the first quarter. We think that's a combination of some of the switching that we mentioned earlier, but also the offset of stimulus from last year. We had significant strength in categories that were affected by stimulus.

As far as the inventory positioning, the growth in the US specifically, about 33%. As I said earlier, the vast majority of that is inflation plus the improvements in availability that we have prepared for and intentionally purchased over the last few quarters. And then as I said, there is a portion of the inventory that we'll need the next quarter or two to work through.

Customers responding are very well to the rollbacks. We began those late in apparel in the first quarter and then extended more rollbacks into the second, and we're seeing a good response from both of those. So we think that over the next quarter or two, we'll sell-through the remaining inventory, the increase that we have on the books right now, and as you heard from Brett in the prepared remarks, we did raise guidance for the rest of the year on the top-line.

Operator: Thank you. Our next question is coming from the line of Michael Lasser with UBS.

Michael Lasser
Analyst, UBS Securities LLC

Q

Good morning. Thanks a lot for taking my questions. Brett, congratulations. My question is the cost pressures that Walmart has encountered, comes on the heels of Amazon facing its own margin pressures. So to what extent are these developments reflective of increased competition between Walmart and Amazon, and does it suggest the cost of doing business is rising as the macro uncertainty increases?

And as part of that question, should we assume that if these are just reflective of timing differences that you'll get all of these costs and margin pressures back in the first and second quarter of next year when you lap them? Thanks a lot.

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.
A

Michael, this is Doug. I think it's more about market dynamics than it is relative to competition, and I would expect to get these things back over time.

As we mentioned earlier, things moved quickly in the back half of the quarter, and it just takes a little bit of time to adjust and as we mentioned in the prepared remarks, we're managing things at an item level from a pricing point of view. But below that gross margin line, there were costs related to fuel and then the staffing issue that we mentioned that just need to be resolved. But we see those as being isolated to the quarter.

Operator: Our next question comes from the line of Peter Benedict with Baird.

Peter S. Benedict
Analyst, Robert W. Baird & Co., Inc.
Q

Hey guys. Good morning. And congrats, Brett. So my question is just really on the profit guide for the year coming down, clearly first quarter and then some in the second. Is it right to view the second half profit guide largely intact here? Just curious kind of if your view on the holidays later this year have changed at all and if you've adjusted any orders accordingly? Thank you.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.
A

Hey, Peter. It's Brett. Appreciate it. Yeah, when you look at the full year guidance, the way I would describe it, one quarter-to-quarter I'll probably go out being known for saying quarter-to-quarter margin is tough to predict, but I feel good about the guidance for the full year.

I think, if you work down through the profit, the P&L statement, there's a lot of variables there, more variables than typical because of what we're dealing within external environment. And you look at a range of outcomes of all those variables. When you add that up, you get to a bottom-line and that's what we felt for the full year.

How that comes quarter-to-quarter is a little more challenging to see. We gave guidance for the second quarter. Obviously that's a little closer in, but for the year, I feel good about the guidance and that kind of implies where we think we'll be in Q3, Q4, and as we always do, as we come out of Q2, we'll update you of how we see the world at that point.

Operator: Thank you. Our next question is coming from the line of Kate McShane with Goldman Sachs.

Kate McShane
Analyst, Goldman Sachs & Co. LLC
Q

Hi, good morning. Thanks for taking our question. I just wanted to ask about price gaps in grocery, if you're still happy with where you are with regards to price gaps in light of the level of inflation. And you mentioned trade-down of the private-label, but just curious in terms of maybe trade down from traditional grocery to Walmart grocery. Have you been seeing new customers come into the store?

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

A

Hey, Kate, it's John. Let me take the first question. On price gaps, this is of course something that we look at every week, every day, and our role with our customer is to make sure that customers can find values on everyday goods.

I think that my team specifically and our supply base, we need to do more to control costs to ensure that we can provide great values in retail for our customers. I mentioned a group of categories in proteins and dairy where we definitely see switching as we look at what's happening in the baskets. So, I think we have some work to do in terms of ensuring that we're providing the right values and we're going to do that across the second quarter going into the rest of the year.

Operator: Thank you. Our next question is from the line of Christopher Horvers with JPMorgan.

Christopher Horvers
Analyst, JPMorgan Securities LLC

Q

Thank you. I had a follow-up to that last question. So, the price architecture across retail has been pretty rational in pretty much every category. Are you seeing any change from the traditional grocers in terms of maybe they're becoming more high-low than they had been and getting back to where they were pre-COVID?

And related to that, you mentioned rollbacks and being an advocate for the consumer. Are the rollbacks focused in seasonal category where the inventory is heavy, or is there some rollbacks also occurring on the consumables side of the business?

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

A

We've really seen strengthening in grocery over the weeks in the quarter. The quarter strengthened on the top-line later into the quarter and remained strong early in the month of May, favored by positioning, we're happier with our inventory levels versus where we have been in previous quarters, and then with warmer weather, we've seen a reaction from the consumer in the grocery categories.

In terms of the rollbacks specifically, we've positioned those over 10,000 rollbacks in seasonal and general merchandise categories. I mentioned earlier the inventory level up 33%, about – more than half that, a majority of that is not only inflation but it is improvement and availability across the entire network. And then there's a portion of the inventory that the rollbacks and other things that we have in place already will help us sell-through over the next couple quarters.

Operator: Our next question is from the line of Robbie Ohmes with Bank of America.

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Q

Hey. Good morning. I wanted to ask just what you are seeing in the eCommerce outlook from here. Are people shifting back to stores? How should we think about that? And I think you mentioned the global advertising business was up 30%. How was that versus expectations, and how should we think about that going forward as well?

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

A

Yeah, in terms of eCommerce, we had about a 1% increase in the first quarter which is similar to Q4 last year. We definitely had pull-forward in growth over the last year or two given all the stimulus and change in consumer behavior. Stores were strong in the first quarter, but what we're seeing so far in the month of May is strength in both channels. So, it looks like the growth is more evenly spread, at least up to this point.

On advertising, we're pleased with the performance in the growth in the US market and the Walmart Connect team continue to make progress and grow our advertising business, and we feel like that's an exciting part of what we're doing is, one of our things that we stay focused on is the reshaping of the business and building a flywheel that will serve customers but also help the company raise [ph] income (38:39) levels and enable us to lower costs for our customers.

Kathryn J. McLay
President and Chief Executive Officer, Sam's Club, Walmart, Inc.

A

And this is Kath from Sam's Club. I'm [indiscernible] (39:08) our income growth by 22% which is a really nice blend of curbside which we launched 18 months ago and as well as direct-to-home. And traffic really is strong into the club at 10%, so really nice blend of members shopping us across all channels.

Judith McKenna
President & Chief Executive Officer-Walmart International, Walmart, Inc.

A

It's Judith here from International, similar trends across the International business, really encouraged at looking at some of the two-year eCommerce stacks that we're seeing around the world. So, Walmax at 185% two-year stack, China 149% and Canada at 112%. Similar blend as we have seen people coming back into our stores as well. The team are keeping momentum in eCommerce.

From an ad-tech perspective, and advertising revenue, Flipkart in particular are doing a really nice job here in building out that platform and supporting small sellers as well as [ph] earn that (40:07) business in new revenue streams, so they saw some good growth year-on-year in that and then we're taking a lot of learnings from them in that space as well.

Operator: The next question comes from the line of Oliver Chen with Cowen.

Oliver Chen
Analyst, Cowen & Company

Q

Hi. Thank you. In the prepared remarks, you called out timing strategy a few times. As we think about timing and managing the inflation relative to what you can do on the top-line, I would love to hear more about that in our modeling.

And second, just a bigger picture question on Walmart+ and the flywheel. I would love any updates there. It looks like you're making lots of great progress. Congrats Brett, as well. Thank you.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.
A

Thanks, Oliver.

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.
A

On timing, Oliver, a few things that happened in the quarter that we did mention of course. There was inflation that came to the quarter in terms of cost of goods. Then there was the fuel cost charges that we mentioned that came in at a very fast rate, really late February, early March, and then there was the pressure on wages that was really the month of February after the Omicron environment. And for the most part, I feel good about the way we have those costs positioned for now. Of course, it could change given how dynamic the market is.

And then on the entire flywheel, Plus is an important piece of the flywheel. When you look at the flywheel and step back, we have the business that's in stores, we have our eCommerce business including a Marketplace, we're making progress in health care and financial services with the acquisitions that we managed to complete and have under the one banner. And then Plus along with Walmart Connect and data ventures are all important pieces of the flywheel.

Really pleased with the progress the team has made in terms of growing the pickup business and offering more slots for customers, becoming more flexible and our NPS scores are improving in those categories. And it's great to see the team make the progress they've made.

Operator: Thank you. The next question is from the line of Rupesh Parikh with Oppenheimer.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.
Q

Hey, good morning. Thanks for taking my question. So, I just wanted to ask on the Walmart US, the inflation levels you guys are seeing. Is there any way you can quantify the level of inflation you're seeing across both grocery and GM? And at this point, any signs that maybe some of the inflationary pressures are starting to peak?

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.
A

Yeah, I'll jump in. I think, John, you can add what you want, but on the food side, we're seeing double-digit inflation and I'm concerned that that inflation may continue to increase. And then on the GM side, we may see that turn faster during the course of the year, so when you look at our inventory numbers, part of what's driving the inventory up as we mentioned earlier is that food is just inflated, so we'll manage in-stock, we'll manage features and food.

When you think about the general merchandise side, break that into apparel and hardlines, apparel, we were appropriately aggressive as we started the year in terms of our inventory levels. And as we mentioned before, we can rollback prices in apparel as we've done and still be helpful from a margin mix point of view and we'll work through that as we go through the second quarter and beyond if necessary. But the good news is, we've got the summer in front of us and much rather have these issues in March and April than to have them later in the season.

And then on the hardline side, kind of the same thing, we've got basic side counter in-stock that needs to be strong. And on the non-basic goods that we feature, we'll manage those inventory levels, take rollbacks in some cases to manage through the total. And as the customer pays more for food, their GM behavior is something that we'll watch closely. We'll not only watch the opening price-point and pack size change on the food side for some customers that move to private brands, but we'll also watch what that means for the general merchandise side of the business.

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

A

Yeah, as Doug said, I feel really good about the rollbacks and the rollback presentations we see in stores. I've been in stores all over the country. The stores are excited about the rollbacks and customers responding. The execution has been strong. And as Doug mentioned with food inflation with the growth we've seen in the first quarter, I'm also concerned about the rate at which prices have risen in the country and our team, our supply base, we need to do more to keep costs low, and where we see the switching from brands to private brands we'll continue to watch that for a group of customers but we've got to all work harder to keep prices low for the American consumer.

Operator: Our next question comes from the line of Michael Baker with D.A. Davidson.

Michael Baker
Analyst, D.A. Davidson & Co.

Q

Yeah, hi. Perfect segue into my question, just following up on that. I mean there's some countervailing things that I'm hearing and I guess is that there are a lot of different product categories but you're talking about keeping prices low and rolling back. And that's really I think always been your mission in inflation environments is to make sure the consumer can still afford basic needs. But then you also were talking about starting – taking – I think you were saying taking more price increases as we go ahead and catching up on some of the timing on some price increases. So can you help square those countervailing wins if you would? Thanks.

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

A

Yes, happy to talk more about that. When things like cost of goods increase and we make the decision with our supply base that that's appropriate, then those types of increases do flow through retail pricing, but there were some things in the first quarter that happened very quickly, we mentioned the labor after the Omicron variant, we had a significant number of people come back where we had been over-scheduling and over-staffing due to leaves, all came back at the same time.

The fuel increase that happened so quickly at the end of February early into March, those kinds of things along with we mentioned charges in supply chain and then we had this fire, which our team did a wonderful job keeping associates safe and getting them out of the building. But we lost those centers. Those were costs that came in very quickly that we feel are more isolated in the first quarter and some of those costs did not flow-through because we believe they were short-term in nature.

So we'll continue to flow what we need to flow at the right timing, but Brett said something earlier that's really important. It's very difficult in an environment that's had so many [ph] dynamic (46:07) changes to manage the margins quarter-to-quarter.

Over the longer-term, our team is very capable of managing these quarters and we've done that for a long time, but not all the costs and changes happen when the quarter begins and when the quarter ends.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.

A

One of the more fun and interesting parts of retail is the management of margin and blending the portfolio of items, and I always remember one of my first buying responsibilities was in food and the leader in our area talked to us, this was quite a long time ago, about profit for the month and profit for the quarter and that we needed to raise profitability, and so he asked the buyers, I was one of them, to come back with a plan on what prices we were going to reduce by the end of the day.

And I paused for a second and thought, ah, we're going to raise profit by reducing prices, because I was pretty new, a rookie, but it's really cool to go back and look at which items maybe elastic that have above-average margins. Bring those prices down to mix yourself up, so part of what's at play here is you've got food inflation moving up, but we've got general merchandise categories like apparel and some of our hardlines categories to play with, and the beauty of it is customers are even more price-sensitive right now, they're paying close attention, fuel prices are high, food prices are high, and so when you bring something down in sporting goods or hardware, one of these other categories they notice even more than they would notice before and that makes the elasticity impact be different than it would be otherwise, which blends the mix up. So what basically you end up with is a bunch of buyers that are portfolio managers.

Operator: Our next question is coming from the line of Robert Moskow from Credit Suisse.

Robert Moskow
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Thanks. As a follow-up to that anecdote, isn't that also saying that really there's not much you need to do on food prices that the consumer seems to be absorbing those higher food prices very well, shifting more of their spending to food instead of gen merch? So how aggressive do you think you really need to be on food pricing and private-label in this environment? It sounds like you want to focus more on the pricing in general merch.

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

A

We'll manage both. I mean, price gaps matter and we know where to put our price gaps to grow profitable growth, so we'll manage both actively. And we do want customers to have lower prices on food and we want to sell more general merchandise, and so we'll partner with the suppliers on the food and consumables side to try and bring those costs down.

The lead times in many general merchandise categories are longer, so Peter asked earlier about the fourth quarter. Obviously we're thinking about units by category right now, but as we make those unit decisions, many of those are inflated in some ways, so you're managing dollars at the same time you're managing units to get an outcome and we'll actively manage both sides of it.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.

A

And we want to ensure that we don't manage the customer message as an average. We serve a lot of customers and different customers are in different places and we want to be thoughtful about customers all across the country and in different geographies ensuring that all customers can get the value they'd expect from shopping with Walmart.

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

A

Not all of them can afford to absorb this and they need our help and so we do, as we mentioned earlier, stay focused on opening price-point food items, a loaf of bread, a gallon of milk, a can of tuna, mac & cheese, protein categories, are we helping a family that's at the lower-end of the income scale to be able to afford to feed their families during this inflationary time, and given that stimulus checks happened last year, there was some benefit to some of those folks that is eroding over time and as we look at the rest of the year, that's something that's on our mind.

Operator: Our next question is from the line of Chuck Grom with Gordon Haskett.

Chuck Grom
Analyst, Gordon Haskett Research Advisors

Q

Hey, guys. Brett, congrats again. Just on the digital side, up 1%, you talked about some capacity issues. Can you talk about that, flesh it out a little bit, and how we should think about the trajectory of digital sales over the next couple of quarters?

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

A

Hey, Chuck. It's John. Good morning. As we said, the growth rate in Q1 was 1%. Same as the fourth quarter. As far as capacity, what happened in Indianapolis was a tough event for the team to go through. Our team did a great job of keeping people safe. Everyone was out of the building in less than five minutes, but the building was a loss. It was a large fulfillment center in our network.

The positive out of that is we have a lot of stores and we have other fulfillment centers and within about 72 hours, the team was able to reroute the majority of the orders into other places in the country. There was certainly some logistics costs with doing so because it was such a big center, but they moved relatively quickly.

There was some top line impact, as you can imagine, in each of these centers particularly with our assortment including our fulfillment services, they are unique items that are in each of those facilities, and as Doug said, just like our lead times are long in general merchandise, so are that of our suppliers and our sellers.

So there's some impact there but looking at the business most recently as we talked about with Walmart Connect and other parts of commerce, now that we're into the second quarter, early signs of May are given some of the increases in temperature, the seasonal categories have really taken off and that would include walmart.com and our eCommerce business.

Operator: Our next question is coming from the line of Paul Lejuez with Citi.

Paul Lejuez
Analyst, Citigroup Global Markets, Inc.

Q

Hey, thanks, guys. You mentioned less gross margin pressure in 2Q versus 1Q, I believe. I'm curious if you'd expect that sequential improvement to continue in each quarter for the remainder of the year.

And related to that, I'm curious what sort of impact did you see from your higher-margin growth businesses this quarter and do you expect those businesses to have a more material positive impact as we move through the year? Thanks.

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

A

I think on margins in Q2 versus Q1, we still have this issue where we've got to make sure we're doing everything we can with our suppliers to manage our costs so that we can keep food pricing in a great spot for consumers. We think about our price gaps every day, we talk about it every day, every week and we manage those carefully.

And what we need to do is work together with our supply base in categories like we mentioned in proteins and dairy where we see some switching from brands to private brands, and we see switching from gallons of milk to half gallons of milk, as I said this morning we've got to do what we can in those categories to keep costs low.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.

A

I think the biggest issue as it relates to gross margin Q2 through Q4 will be mix and we didn't have favorable weather in the first quarter. As the temperatures warmed up we saw stronger sales in GM, apparel included, and so one of the reasons why we mentioned that Q2 looks like it'll have less pressure is that we think the mix will be different in Q2 than it was in Q1.

Operator: Our next question is from the line of Ben Bienvenu with Stephens.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Hey, thanks. Good morning. And Brett, I'll add my congratulations. Thanks for everything through the years.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.

A

Thanks, Ben.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

I want to ask, with the start to Q2, where do you feel like you have the best handle on the business, what are the biggest challenges you're still seeing? And then you noted your goal for the remainder of the year is to get back to your original guidance. If you're going to achieve that goal, how do you think you're most likely to do that?

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

A

Let's go back to Paul for just a second. I think we missed the second half of his question and then we'll come back.

He asked about the higher-margin growth businesses like Walmart Connect and whether we expect those to continue to grow. We shared that Q1 was up about 30%. Those ancillary businesses in the US and around the world are growing and we expect that to continue and we're excited about that. And frankly, when I look at the Q1 results, I understand the response to a miss but I hope that some of the underlying improvement that's happening and the shaping that's taking place with the business model isn't totally lost on people, as I think that's going to continue and it'll result in a company that's more resilient and more diversified on the bottom line.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.

A

And on the mix, as far as where we are now, really good improvements since late in Q1. We mentioned the rollbacks in apparel. Those are high-margin businesses that are accretive to the total, so the rollback is there, with the rollbacks they still helped the business in terms of sales and margin. And then really, really pleased with results in commerce and stores regarding seasonal merchandise and what we're seeing as we get into the second quarter now that we've got some warmer weather. It looks really strong from our view.

John R. Furner
President & Chief Executve Officer, Walmart US, Walmart, Inc.

A

And, Ben, you asked about the comment – I made the comment about being focused still on our original guidance, and I think that's a statement to what I see inside the company, what I've always known the company would be, high sense of urgency, really smart people able to work on in any kind of challenge, we've seen that over the last 2.5 years. I think we've managed incredibly well, the last 2.5 years, so we're still focused on what we said at the first of the year, but felt it appropriate to reduce the guidance officially based on the first quarter. But it's one quarter to the year, and there's still a lot of levers to pull, so that's why I made that comment.

Operator: Our next question comes from the line of Scot Ciccarelli with Truist Securities.

Scot Ciccarelli
Analyst, Truist Securities, Inc.

Q

Good morning, guys. So the last time we saw consumer weakness in greater private-label concentration, it started to become self-fulfilling meaning consumers were focusing on private-label and so you provide more shelf space to private-label to drive more private-label sales, so on and so forth.

So when you look at today's environment and the price increases vendors are trying to pass on, should we expect private-label mix to continue to increase in the coming quarters? Thanks.

C. Douglas McMillon
President, Chief Executive Officer & Director, Walmart, Inc.

A

Yeah, I wouldn't want to see us adjust shelf allocation much. This is more about just staying in-stock and letting the customer decide.

Brett M. Biggs
Chief Financial Officer & Executive Vice President, Walmart, Inc.

A

Yeah, I feel exactly the same way. We serve a broad range of consumers and we serve them in different places. We serve customers in the store, we serve them at the curb and pickup, we serve them in their home in their refrigerator and we deliver direct, so I think we just have such a broad range of offering that we can serve all consumers well and if customers buy one item more than the other, we'll replenish it that way, but I see us staying in position to be able to serve a wide range of consumers.

Operator: Thank you. At this time, we've reached the end of our question-and-answer session, and I'll turn the call back to Dan (sic) [Doug] (57:09) McMillon for closing remarks.

C. Douglas McMillon

President, Chief Executive Officer & Director, Walmart, Inc.

This is Doug McMillon. There are a lot of Dans around here, though.

Operator: Sorry about that.

C. Douglas McMillon

President, Chief Executive Officer & Director, Walmart, Inc.

No problem. I'll start by thanking Brett, and Brett has done an outstanding job for a lot of years all over the company. He's been a great partner not just to me but to all of us. His judgment, his character, his knowledge of the company, just who he is as a person, it's a great accomplishment we've some to see of both Walmart and you've done a great job and we're going to miss you. And I wish we'd gone out on a great quarter celebrating you in that way, so you can chime-in from the cheap seats when things get better.

Speaking of things getting better, we're motivated to have a really strong year. We're understanding the environment, trying to convey to you all what we see going forward, but we expect customers and members to come our way. We're going to keep growing overall. We're going to keep growing our share and we're going to change the business model of the company to be more profitable. And there were some things that happened during the quarter that were different than what we expected, and we're trying to be very transparent about those things. And then with performance, earn your trust and just keep moving forward and make this as isolated of an issue as we can.

There is a lot of uncertainty looking forward. Things are very fluid. I know you all are gathering information every day, and so are we, and as I talk to people across the country and across the world, there seems to be more uncertainty now in a very fluid environment, and so we'll just deal with that and we like the hand that we've got to play.

We've got a great set of assets. We've got a great set of people and when things are more difficult we should outperform, and so our first quarter performance is a disappointment to us and we're going to it put behind us and have a strong year.

Looking forward to seeing you in person, those of you that can make it to the meeting on June 3. We'll be down in Fayetteville and we're going to have a bunch of associates and kind of get back to a pre-pandemic-type week which we're all excited about and we hope to see you there.

Thank you, all.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.