Walmart's Fiscal Year 2014 Q1 Earnings Results
Media Call Transcript
May 16, 2013

Charles Holley, CFO Walmart: Good morning, everybody. Thank you for joining us. As you know we did release our first quarter earnings for this year. What I'd like to do is just cover some of the highlights quickly on the company in each of our segments, and then we can turn it over for questions. Our net sales for the quarter were over $113 billion. That was a $1.2 billion increase as we reported. That did include a $1 billion negative impact from currency rate fluctuations. We also had very solid cash flows though, of almost $2 billion. Walmart and Sam's Club did lever their expenses where they grew their expenses at a lower pace in sales. – that will be very important in our business model. And that was in spite of some very soft sales which I'll touch on in just a minute. Our earnings per share were $1.14. That compares to $1.09 last year. That's a 4.6 percent increase. And as a reminder, our guidance was $1.11 to $1.16. So, despite the soft sales we were able to bring in our earnings per share within the original guidance that we gave.

Turning to Walmart, looking at the sales they had $66.6 billion in net sales and like many retailers that you've probably heard from, there were a lot of factors that contributed to the lower expected comps which were negative 1.4 - pressured primarily by tax refunds; the reversal of the payroll tax cut - the 2 percent' cold weather, colder weather than we experienced - especially compared to last year which was a very warm winter and early spring. And then we had - we did not see the inflation in food categories which we thought that we would see. So there were a number of factors that contributed to the first quarter being soft sales in our Walmart U.S.

International came in on the reported revenue of $33 billion. That's about a 2.9 percent increase. However, the way that we look at our underlining business is without the impact of that $1 billion in currency I referred to. If you took that out, the increase was about 5.4 percent. Still softer than what we would have expected, but I think that we see some softness in all markets around the globe. I will say that we did gain market share in most of our markets. I think the disappointment in international was probably expense management. We didn't lever our expense and they're really several factors. We had higher wage inflation than we really would have expected; higher indirect taxes and there were strategic investments that we've been making in e-commerce and some of our leverage areas. I think second quarter we'll continue to be under pressure, but we do see improvement in the back half of the year. Sam's had a good quarter, and to tell us more about that performance, I'm being joined today by a special guest, Roz Brewer. Roz is the Sam's Club President and CEO. So, I'd like Roz to maybe cover some of the highlights for Sam's. Roz?

Rosalind Brewer, CEO Sam's Club: Thanks, Charles. Good morning, everyone. At Sam's Club, for the first quarter I am happy to share that our expenses declined this quarter and we grew membership income and we delivered both sales and operating profit ahead of last year.

Let's go over a few particulars here. Our comp sales without fuel were up .2 percent and within our guidance and traffic was up 1.3 percent. As cooler weather and lack of inflation created [softness] in our top line results. Inflation for Sam's was about 50 bases points compared between 250 and 300 bases points in the first quarter last year.

So, as I initially mentioned, we did leverage expenses this quarter at the same time we grew our membership income and we delivered operating income increases of the 7.4 percent this quarter. From a membership prospective, which most of you all know, is really an integral part of our business, our comp sales and traffic patterns continue to indicate that our members do remain slightly pressured during this time. Our small business focus - our small businesses tell us that you know, they are at historically low levels in terms of their optimism. And they tend to adapt to the higher pay roll taxes that they're experiencing, and they have some cautious consumer on their side as well. So, in response, we're focused on increasing our awareness of the value that Sam's Club brings to these small businesses. And a big part of our membership strategy is really playing out this quarter – and it's being enhanced by our membership offering.

We had mentioned to you before that we were in a pilot test in the Texas region which is about 12 percent club base. Looking at what we can do to improve our membership program, and I'm pleased to say that as of yesterday we went national with our program, we increased our membership fee nationwide, and as Charles mentioned to you before, we took an increase. We started off $45 for both our advantage and our business member base. This reflects a $5 and a $10 increase respectively. And our fee for our plus membership is going to remain at $100. This is our first fee increase since January 2006. And the test proved to us that we don't expect any significant impact to renewal rates and to new signups.

We'll continue to offer this additional value to our members, and we're also introducing our first instant savings book, and it's available to all members May 15 through June 9. It includes over $3,500 in savings on nearly 100 items. And this is both in-club and on SamsClub.com. So, our plus members will continue to receive some pretty exclusive offers automatically loaded onto their membership card. So this is very new for us. And we'll also include fresh items in our private label business as well.

We're also going to begin to see a change in our merchandise strategy throughout the year. In the past, we had great success in treating all of club essentially the same. But, we've learned that our member base varies around the country. Moving forward, our members will be experiencing some exciting in merchandise, and we'll heighten that with local brand, and we'll display it with a new level visual excitement inside the club. So, these are all changes to expect. And we're also adapting to serve our members who are shopping online and in our club.

Just a little bit about our e-commerce business, our mobile app is giving our members this personalized e-commerce that we've been striving for. But before visiting the club, our members can build a shopping list and fill prescriptions, and once in a club, they can research merchandise information and then compare costs. So, this has been a successful for us. And along with Walmart, we're also piloting the Scan and Go app and that'll be in 50 clubs by mid-June. So, the combination of our strategies position us well for the second quarter – we're expecting comp sales without fuel to increase from 1 to 3 percent. We feel pretty confident that the combination of our new club growth, our membership improvement, our exciting and locally relevant merchandise and some of our e-commerce will really help drive some momentum into the second quarter. So, Charles, that's just a brief overview. I'll turn it back over to you.

Holley: Thanks, Roz. Just as a reminder our financial priorities remain growth, leverage and returns. And we look at growth, we added 84 units around the world - 5.2 million square feet. We now have about 10,557 units. As far as leverage, like I said, we wish we had levered a little more. The soft sales hurt us a little bit in this quarter, but we're very committed to making sure we leverage for the year. And that again is growing our operating expenses at a rate slower than sales, and I think the quarter also proved, despite a very tough sales environment in the U.S. , we still have a very good ability to provide really good returns for our shareholders. With that, I'll open it up for questions.

Moderator: At this time, if you'd like to ask a question, please press star and one on your touchtone phone. You may remove yourself from the questions pressing the pound key. Again, star and one to ask questions. We'll go first to the side of Jessica Wohl with Reuters. Go ahead your line's open.

Jessica Wohl, Reuters: Hi. Good morning, everybody. Charles, wondering if you could talk a bit more about the same store sales results you saw at Walmar U.S. We've seen other retailers also have some disappointing sales to the quarter. How do you think your position versus other retailers and what are you going to do to make sure that you can maybe make up the sales that merchandise further into Q2?

Holley: First, I'll address the first quarter, then going forward. There's a lot of noise … you know one of the questions that I anticipate that's kind of related to your question is what's going on with the consumer in the first quarter. And I think it's very difficult to make a solid conclusion about the consumer. I'm not sure that there is anything different than there was last year with the consumer. There's a lot of noise in the quarter, for all retailers. I think we'll have to get well into the second quarter to make any definitive conclusions. I will say this, starting off with the second quarter; we see very healthy positive comps right now. So, we feel like that getting past the first quarter is important for us as a company in the U.S. and we feel like the consumer, although our consumer still stretched, they still have a lot of concerns about the economy, we feel, you'll see a more normal second quarter.

Wohl: OK. And then, can you talk just a little bit about inventory and any of the spring merchandise that you have? Are you going to have to discount more than previously planned to get rid of that stuff now that we're finally seeing spring?

Holley: You know, right now, I don't anticipate that we would have any extraordinary markdowns of that inventory. Now, if it snows again this weekend and the next weekend, and everybody's laughing here because it did snow in Bentonville about two weekends ago which I don't know that it's ever done that. But I think that we've gotten through a lot of the cold weather and we do anticipate that we will be able to sell through the inventory that we do have. Will there be markdowns? There could be some, but I don't anticipate any extraordinary.

Moderator: We'll go next to the side of Anne D'Innocenzio with the Associated Press. Go ahead. Your line's open.

Anne D'Innocenzio, Associated Press: Hi. I wanted to ask you in terms of, can you breakdown the first quarter? You know, what was the biggest impact, you know, and you sited weather is a big impact and payroll tax. But, can you just break it down for us? I mean, there's been a lot of factors. But what would be the biggest impact on, you know, hurting sales, what would be the second biggest impact?

Holley: You know, that's a good question, and it's hard to give a lot of… there's not a lot of science to it. So it's hard to give you an exact number, but I think what we have said… we feel like a combination of all factors I've listed, probably hurt our comp sales by about 200 basis points. One thing I can say is that if you look at the two weeks of the quarter, that's when we would have expected a lot of the IRS refunds. And if you pulled out those two weeks of the quarter, our sales comp would have been around flat. So, that kind of gives you an idea about the impact of the tax refunds. But then again, it's hard to give a specific number to any one of those items. We do know that the lack of IRS refund checks did hurt our consumers. In fact, the IRS said that they estimated that they were about $9 billion left in refund checks. And we certainly cashed less of those checks.

D'Innocenzio: And now when they got the checks, did they spend or did they save? What was the trend that you saw that was different from last year?

Holley: Again, that's difficult to know exactly, but we do have an assumption that when they cash the checks in our stores that they do spend some portion of that in our stores. And again for the quarter, we did cash less checks than we would have seen last year.

D'Innocenzio: Because of the delay, right?

Holley: Yes. Less money. I mean we say delay… the IRS has estimated that there's $9 billion less in tax refund. So we don't know if it's a delay or if it's permanent.

D'Innocenzio: OK. Thank you

Moderator: We'll go next to the side of Stephanie Clifford with New York Times. Go ahead, your line's open.

Stephanie Clifford, The New York Times: Thanks. Charles, on the FCPA cost, I'm curious as to why they increased so much more than you guys said and anticipated than in prior quarters.

Holley: Well, a lot of what we… We broke out the cost so that you could see between the FCPA investigation and compliance costs. A lot of the increase did come from compliance that we're putting into our countries and I think that we just misestimated at the beginning of the quarter.

Clifford: Mhmm. And then I'm also curious if you're getting feedback from your customers on Bangladesh. Or is that something that's not really on their minds.

Holley: No. We haven't. We really haven't had much feedback from that.

Clifford: OK.

Moderator: We'll go next to the side of Karen Talley with Dow Jones.

Karen Talley, Dow Jones: Thank you very much. Charles, how long do you expect your customers to be in a funk?

Holley: Well, like I said, I don't know that I would say the customer is in a funk, but there was just a lot of noise with a lot of things happening in the first quarter like we went through. And I think that we've gotten through a lot of that in the first quarter. And I think we'll have a better idea about the customers in the second quarter. Having said that, you know, I don't think it's much different than what we would have seen in prior quarters of what affects our customer. The number one core concern for customers remains jobs and employment. The number two is rising food costs. Number three is gas/energy prices. Number four - it's kind of a distant number four - would be taxes, going forward.

Talley: Thank you. And, uh, on the employment, given the unemployment level is falling, are wages not rising for your customers?

Holley: Yeah, and I don't have …

Talley: Although more are not getting jobs, or are they just stagnant?

Holley: I don't really have any data right now to be able to answer you as far as what the wages are doing for customers.

Talley: OK. Thank you.

Moderator: And again, star and one to ask a question. We'll go next to the side of Barney Jopson with Financial Times. Go ahead.

Barney Jopson: Yeah. Hello. Good morning, everyone. Just on Bangladesh, you said you were not going to sign the safety agreement put together by the labor groups and some European retailers because you don't like the government and dispute resolution mechanisms. Can you tell us a little bit more about what concerns they raise? Why you don't like them?

Holley: We've issued a couple of releases on that already. So I really don't have much more to say in this call about Bangladesh.

Jopson: OK. And Charles, on international expenses, you talked about external factors: wage inflation and taxes, but your transcript refers to the need to increase cost management would suggest there's some internal factors as well. Can you tell us what's going on there with your instability inside the company to manage costs?

Holley: Yeah. If you look at the U.S. business which is a much more mature business than our international operations, there's a lot more systems that aid management and forecasting when the associates need to be there, when the customers are there, on how we go about handling our inventory in the most efficient manner in the store backrooms. Those kinds of systems are not near as far along as in international and we are focused on getting the kind of technology that has the U.S. has out in our countries.

Jopson: OK. Thanks.

Moderator: We'll go next to Andria Cheng with Marketwatch. Go ahead your line's open.

Andria Cheng, MarketWatch: Hi, Charles. I just wanted to clarify, cause I know the last that we talked I saw you were saying that Walmart hasn't really been seeing an impact on payroll tax so the beginning of the quarter after early February you have seen an impact from the tax refund so I just wanted to clarify as far as what kind of other additional changes that you guys are seeing like the rest of the quarter and those gasoine prices did decline. So, did Walmart not see any benefit from them?

Holley: You know, I think gas prices actually peaked at the very end of February for the U.S. so you had rising gas prices basically for the first part of the quarter, and then they moderated. I wouldn't call them low though. So, they do impact our customer when they go up. As far as taxes, the payroll tax, we didn't see or hear much from our customers until toward the end of the quarter. And then our customers have started noticing I think that their checks are less because of the payroll tax. I think at the beginning it just wasn't a focus for them, but as the quarter went on, we are starting to hear more from our customers that they do see that.

Cheng: So, it's fair to say that you do see an impact from the payroll tax?

Holley: That's probably some sort of impact, yes.

Cheng: OK. Thank you.

Moderator: And we'll go back to the side of Karen Talley with Dow Jones for a follow-up. Go ahead, your line's open.

Talley: Thank you. Would you say that this is fair that you're still seeing your customers [inaudible] by jobs and other unemployment concern?

Holley: I think it's toward the very top of their concerns. Yeah, and I don't know how that speaks, I don't have data to tell you about unemployment – I just see the numbers you see. But our customers tell us in our surveys that jobs and unemployment are still very high on their list of concerns.

Talley: Thank you.

Moderator: And again, star and one to ask a question. We'll go back to the side of Andria Cheng. Go ahead. Your line's open.

Cheng: Hey, Charles. In Q2 one of the kind of one of the headwinds, if I'm reading it correctly, is on the expense side, so can you elaborate what kind of expenses Walmart anticipates? I'm curious to the lack of food inflation – what kinds of food are you talking about.

Holley: I'm not sure I understood your expense question. Could you ask that again?

Cheng: Um, I think the part of the region that the guidance fell below …

Holley: Oh.

Cheng: … is because of expense, right? So what areas are you guys increasing spending on?

Holley: Well, as we had said our FCPA compliance expense has ramped up, I believe between $65 and $70 million for the quarter. That would be one. Another one in the corporate area, we're investing very heavily right now in our leverage areas. Particularly if you look at we're setting up shared services group down in Central America that will serve all of our Latin American operations. And that's still in the ramp up stage so you will end up having increased expenses for the short term. And in the long term we believe it will be a benefit to our company. Also one other item I should mention is our global e-commerce. As you know we're ramping up our global e-commerce and I think we mentioned that it would be a net increase of at least 2 cents a share related to global e-commerce investment.

Cheng: OK. Sorry about food inflation – food deflation?

Holley: Yeah, and the food, I think if you read the script yet, we expected to have more food inflation than there was. And basically it was around flat give or take a few bases points. Last year in the U.S. Walmart, you would have seen around 300 bases points of inflation. And Roz, you might say what you're seeing about Sam's.

Brewer: Thanks, Charles. So at Sam's we have a slightly different member-customer base than Walmart and we have a higher percentage of food. This quarter we saw about 50 bases points of inflation in our business, but that's compared to the same quarter last year around 250 to 300 bases points. So definitely for Sam's, inflations was one of the larger factors impacting our top line.

Cheng: OK. Thank you.

Moderator: And we'll go to Jessica Wohl with Reuters. Go ahead, you're line's open.

Wohl: Hi. Just following up a bit about Andria's question. Which item in particular is the biggest cost pressure in Q2? It sounds like e-commerce 2 cents per share, but that was planned for the year so is the FCPA cost going to be higher than anticipated earlier in the year? Or is it the leverage areas you called out? Maybe that spending is coming?

Holley: I think it's a combination. I think the first thing is if you look at international, their sales are a little softer than we would have anticipated, so that makes it harder, more difficult to leverage your expenses. The FCPA expenses are a little bit more than we would have anticipated. We would have anticipated $40 to $45 million a quarter and they're coming in right now at $65 to $70 million, we think for the balance of the quarter. But that would have been part and then some of the projects that we have for our global leverage area, like I said those are ramping up little faster, a little more than anticipated.

Wohl: And just to be clear, you said that it'll be about $65 to $70 million per quarter in FCPA expenses?

Holley: For the second quarter

Wohl: Just for the second quarter?

Holley: We haven't given guidance for the balance of the year. We haven't given new guidance for the balance of the year. But we have seen that it's ramped up in the first quarter. We would expect that to continue at least until the second quarter.

David Tovar: And Jessica keep in mind on the FCPA, it's both the investigation and the compliance review. And in the state of the compliance review, we're actually now implementing enhancements in our compliance programs and that's adding additional costs to it, but we believe that those are wise investments for us to be making.

Wohl: And, can you talk about some of the most recent parts of the compliance review that you've been … where those are coming from? If the investigations are ongoing, we get that, and the compliance review is leading you to make changes. What changes are you making that are costing more?

Holley: Yeah, I think that that should probably be taken offline as far as earnings. All I can tell you in this call is $65 to $70 million dollars in combined costs in the second quarter.

Wohl: Thanks.

Moderator: We'll go next to Shelly Banjo with Wall Street Journal. Go ahead, you line's open.

Shelly Banjo, The Wall Street Journal: Sure. Thank you so much. I just had a quick question for you Charles in terms of the second quarter, you had said that already you're seeing signs that the second quarter would be better. And I'm just wondering if so many factors in the first quarter had to do with macro factors, what of those do you expect to change in the second quarter?

Holley: Well, you know, we're not anticipating, there's no tax refund issue, and we do know that that did have a big impact on our in the first quarter Walmart U.S. We're not expecting to have some unusually cold weather, and that had a big impact in the first quarter. And like I said, we're already seeing very healthy, positive comps starting the second quarter in the Walmart U.S business. I believe Sam's has also seen very healthy comps also.

Banjo: And then just to follow up on that, Sam's is experiencing softer sales, not as much as Walmart. I know you have different customer types. What are the Sam's customers… Or, what are the Walmart customers feeling the Sam's Club customers aren't?

Holley: Why don't I ask Roz to maybe address what they see with their member?

Brewer: Yes. Good morning, Shelly. So there is a bit of a different between a traditional Walmart shopper and a Sam's shopper. A couple of things that we're seeing is, we've got to balance our business member with our average consumer and you know I'll tell you that our business member continues to still take care and try and manage their business day-to-day. We're delivering for them just in time on the day of delivery for a lot of their items that they need, particularly for our restaurant owners we're still seeing that business move forward positively. We're also seeing a lot of good things happening around new merchandise. And we're introducing them into our clubs and we're getting some really good response to that great color around our seasonal merchandise that picked up right toward the end of the close of the quarter. So, we're seeing some advancement, Shelly. Just because of some of the changes we're making in our merchandise and our business members spending to support their businesses to keep them going, you know, moving forward. So things are slightly better at Sam's than they are at Walmart stores.

Banjo: Just one more question if I can. In terms of payroll taxes and healthcare, have you guys, on the expense side, have you seen any increased expenses now that the ACA is coming closer?

Holley: We haven't seen anything that's significant that would vary from what we've seen in the recent past.

Banjo: Thank you.

Moderator: And we'll go to the side of Mary Thompson with CNBC.

Mary Thompson, CNBC: Appreciate it. I was just hoping you could give us more color on the weakness that you saw in international sales. Where you saw weakness and what was behind it?

Holley: You know, it's interesting because if you look at our results for the most part, we gained, like I said earlier, we gained share in most of our markets. The interpretation that we have is that those markets are just softer economically. And what's important for us is I think we drive some excellent offering for our customers especially when things get tight. Our everyday low price really does work well with those. And we will continue to focus on giving the lowest price possible to our customer because they're obviously getting squeezed in a lot of our markets.

Thompson: You said that while you gained share, the sales were a little bit softer than expected. Was there a particular geographic region that was weaker than others?

Holley: Not really. I think that if you look cross the boards to most of our international operations, the sales were probably less than we expected of the beginning quarter. So it's not just pointed to one region of the world.

Thompson: Thanks.