Walmart
Q4 FY '25 Buyside Investor Call
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<u>Presenters</u>
Steph Wissink - Senior Vice President, Investor Relations, Walmart
John David Rainey - Chief Financial Officer, Walmart
Kary Brunner - Senior Director, Investor Relations, Walmart

<u>Q&A Participants</u>

Operator
Greetings. Welcome to Walmart's Fourth Quarter Fiscal Year '25 Buy Side Investor Call. Please note this conference is being recorded. At this time, it is now my pleasure to introduce Steph Wissink, Senior Vice President, Investor Relations. Steph, you may begin.

Steph Wissink
Thank you. Good morning, everyone. During this call, management may make 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 that were issued yesterday for a cautionary statement regarding forward-looking statements, as well as our entire safe harbor and non-GAAP reconciliations on our website at stock.walmart.com.

Bob, turning it over to you.

Bob
Thanks, Steph. Yes. Good afternoon, everybody, and good morning to some of those in the Central Time zone and West Coast. So, it's a great pleasure today to be here with you and host Walmart's CFO, John David Rainey. He joined Walmart in May of '22, and he joined from PayPal as the CFO and EVP Global Customer Operations there.

So, John David, thank you very much, you know, for this opportunity. And just going to jump right in, and appreciate the time. I would just, you know, like to start off on the consumer with a few questions. Just could you give us your thoughts on the consumer overall? I think you said yesterday resilient and consistent behavior, but can you elaborate a bit on what you're seeing?

John David Rainey
I'd be happy to, Bob. And thanks, everyone, for joining the call. And Bob, thanks for hosting us today. We always appreciate the opportunity to come back the next day and talk about our business a little bit more.

On the consumer, we continue to look for ways to describe what we've seen over the past several months, but it's--what we've said is it's steady. It's consistent. There's not a whole lot that feels different than what it did 90 days ago or 180 days ago.

You can tell that consumers are--they still have their wallets stretched a little bit. I say that because what we see in our business is that private brand penetration continues to grow. We still see a shift in the basket from general merchandise to food. But it does seem like there's maybe--like perhaps they're getting a little more conditioned to the price environment where it is. Eggs might be the exception right now. But I say that because basket sizes have increased moderately from where we were a quarter ago.

But, you know, we're still pushing units. We're still seeing good traffic in the store. They're responding to our value proposition. And so, not a lot feels different from--on the consumer from where it was. We, like everyone else, are attentive to economic data and the things that we read in the press. More recently, we've heard things about consumer sentiment possibly ticking down a little bit, concerns about re-inflation. We're watching all those things, but there's nothing that we have seen in our business that would indicate that there's been a step down in behavior or sentiment.

Bob
Great. Thank you. And then just consumer trends by income cohort, and can you just talk a bit more--are, you know, the drivers of the gains with the upper income consumer gaining in other cohorts? E-commerce appears to be a key driver. And can we just walk through some of those topics?

John David Rainey
Sure. This is one of the aspects of our business that we're most excited about. We continue to see share gains across all cohorts, most pronounced within the households that are making more than $100,000 a year.

I believe a lot of that has to do with convenience. We are thought of more for convenience--or as much for convenience today as we are for value. And I'm sure we'll get into some of the e-commerce statistics of why that's the case.

I'd say also that our assortment has expanded quite a bit too. We talked on the last call about a number--the expansion in the number of SKUs that we have on our Marketplace. We can isolate categories of general merchandise on our Marketplace that are growing in excess of 20%, sometimes in excess of 30%, things like auto, patio/garden, toys, pets, other areas that are all growing north of 20%.

So, I think it's two-fold, Bob. It's convenience and what we're providing for our customers and members there, and it's a broader assortment than what we've had historically.

Bob
Great. And can you talk to customer basket trends, you know, opening price points? I think you did mention yesterday, you know, Great Value increased in penetration. Can you just talk through some of that for us?

John David Rainey
Sure. It's probably a slightly more--or has been a slightly more promotional environment than where we were a quarter ago. We do see that. The basket trends, though, still are very similar. People are spending more on food versus general merchandise. Private brand during the quarter, the penetration increased--Carey [PH], correct me if I'm wrong, 70 basis points? 70 basis points.

But what's exciting about our private brand is, if you just take Bettergoods as an example--and for those less familiar with Bettergoods, it's our new private brand assortment that are low-cost, healthy, chef inspired choices. But 60% of the customers that are buying private brand--or that are buying Bettergoods are trying a private brand for the first time.

And so, it really shows that the assortment quality is getting better in the private brand, which is clearly influencing some of that shift as well. It's not all just because wallets are stretched. They've got better options out there.

Steph Wissink
Bob, it's Steph. I would add too, our merchant team is motivated to not only use private brand but in complement with price architecture of some of the brands that we know customers want to explore, try. One of our recent success stories is a brand in the better for you soda category called Poppi, where we engineered a $1.00 price point for a mini can. And we've seen really good success with customers who've indicated to us that they want to try this type of product, but a $2.50 to $3.00 per can price is just too high to justify.

So, we've seen this in areas like breakfast cereal, new form factors within snacking, soda. We've seen some things in fresh, grab and go. So, I think our merchants are really conscious not only of a very robust private brand assortment but also working with our national brand suppliers to introduce price point architecture that makes it really compelling at that opening price point.

John David Rainey
Yeah. And Steph is understating the really good success. The increase in sales we've seen in this one example is like a 10X example. So, it's a really exciting part of our business.

Bob
Great. Okay, so I'm going to wrap. That's the consumer section. I want to move into some housekeeping sort of clarifications, you know, from yesterday's results. You know, based on some of the calls that we had, you know, from investors yesterday, could we spend a few minutes on some what I would call cleanup and housekeeping questions that we dealt with?

John David Rainey
Sure.

Bob
The first one would be--thank you. The first one would be can you clarify, you know, your assumptions around Leap Day? You know, how do you arrive at the Q1 estimates for 100 basis points impact to sales and 250 basis point impact to operating income?

John David Rainey
Sure. I'm happy to do that. And I was afraid that might cause a little bit of confusion on the operating income side. Sales is just kind of math. One day out of the quarter, it's, you know, roughly 1%.

On the operating income side, if you think about last year, we had an extra day of sales, but a lot of the fixed costs in our business did not increase. So, we didn't pay more rent on our building simply because we had an extra day with Leap Day last year.

And so, I'll give you a way to think about that, Bob. And I'm going to generalize a little bit here. But if you think about a 20% SG&A for us, just--let's call it roughly half of that is fixed, roughly half is variable. That's not the exact math, but it's pretty close. And so, you assume that you've got that extra day of sales. The GP, the gross profit, falls down to the bottom line, and all that you have are the variable expenses related to that.

The math on that for the quarter results in about a 250 basis points--basis point headwind for us for the quarter, and the mathematical effect of the full-year as well obviously being a little bit less. But if you were to look at our first quarter guidance and you add both VIZIO as well as the effect of that, it's actually more in line with what we're talking about for the full year.

So, I don't think people appreciate the impact of that one day can have on the profit of our business, but it's pretty significant for a company like ours.

Steph Wissink
Bob, it's Steph. Also, just to double-click on the clarification, we're talking about the impact to the rate of growth.

John David Rainey
Yes. Thank you for that, Steph. Yeah.

Steph Wissink
Not the impact to the margin of the business.

John David Rainey
Yeah, the rate of growth year-over-year.

Bob
Great. Thank you for clarifying that. Second topic that we sort of, you know, dealt with a bit was FX impacts in guidance. Can you just walk us through that a bit? And which markets are the largest drivers of the FX variability for Walmart?

John David Rainey
Sure. For the full year, if exchange rates were to stay where they are right now, the impact on sales would be about 100 basis points. And again, to Steph's earlier point, we're talking to growth rates. And it's about 150 basis points of impact to the growth rate in operating income. For the first quarter, the impact of sales is 150 basis points to the--headwind to the growth rate, and 250 for operating income.

Most of the impact is driven by the Mexican peso. After the election there, and more recently with some of the speculation around tariffs, you've seen a pretty sharp drift in currency rates there, and that impacts our business. Obviously, Walmex is a very big part of our business, and so that has an impact.

But, you know, this is what I was saying, is that one year it's going to positive, the next year it's going to be negative. It's why we tend to focus on what's happening with core business by focusing on currency neutral rates, or a peg is another way to think about it.

Steph Wissink
Bob, as you're building your model and others are building models, it will be an impact most notably in the first couple of quarters and it will start to thin out into the back quarters, using an assumed static rate from where we kind of started the first quarter. So, I would just think through the aftereffects, you know, from a peg to an FX impacted most dramatic in the first couple of quarters of the year as we're lapping favorability last year.

Bob
Thank you. The--I guess just any more color around, you know, November, December, January trends? You know, the narrative in the market is that January was tough out there, but you said yesterday January was your best month. Why the deviation from the overall market retail sales trends? And can you talk to early trends in February?

John David Rainey
I'm not going to speak to February, but I'll give some color on sequencing in the quarter as well as January. The way to probably think about the quarter and the best way to talk about the sequencing is really to combine November and December. And if you did that, November and December looked pretty similar to January. January was the strongest, but it wasn't like we saw this huge step up. It was just marginally better than the other months in the quarter.

Relative to what's going on in the market with retail sales, I think retail sales were more impacted by some other industries like airlines and maybe some others that I'm forgetting. But we actually felt pretty good about what we saw in January.

Steph Wissink
Bob, one of the themes that's been consistent really now for two whole years is this idea of events getting bigger and more concentrated spending in shopping around key events. And that has continued through the fourth quarter, but certainly, you know, even into the latter part of the fourth quarter and around events like Valentine's Day. And this is really where our commitment to express delivery, our convenience factor becomes even more important.

We saw this leading into the Christmas Eve holiday. We saw it around the Super Bowl weekend, and we saw it around Valentine's as well and the New Year. So, I think there's a pattern where people think of Walmart when they're running into a time constraint, and we're there to help them pull off an event. Typically, it's a gathering or a celebratory event. And so, we're really leaning into again. This will be the third year in a row of that posture, for our team to really win the big events and build that mind share and market share around those key events.

Bob
Great. I think you guys were set for Valentine's Day on December 26th in the store that I was in. So--.

Steph Wissink
--Yeah, we were--.

John David Rainey
--Doesn't surprise me.

Steph Wissink
I was just going to say, Bob, we were delivering bouquets of roses, bottles of wine, dinner for the night up until I think 8:00 on Valentine's Day. So, for the procrastinators out there, we saved the day.

Bob
Sounds like a great job. The--if we could shift--you know, focus on strategy a bit, how do you--how do results for FY '25 and expectations for FY '26 reinforce the strategy at Walmart? Like, how do you handicap the largest uncertainties in Walmart's outlook?

John David Rainey
Well, I'll start with I love the hand that we have right now. I feel like there's very few other companies that I can point to that are as sort of immune to some of the macroeconomic factors. Like, if things get more challenging from a consumer perspective, customers are going to come to Walmart and Sam's looking for value. And if things--we get into a more prosperous economy, I really like the hand that we have there too. So, I feel really good about that.

But we're not completely immune. I think the couple items I'd point to that are uncertainties right now are tariffs. That is unpredictable at this point. And as I noted yesterday, we don't have anything built into our guidance for that. We feel like we can navigate that very well, but that's something that's uncertain out there.

Also, I worry a little bit, like, if we were to get into more of a re-inflationary environment and the Fed is now raising rates, like what that might do to wealth effect, consumer sentiment. And--but again, like, if you're going to be a company operating in that landscape, I love what Walmart offers there, so feel good about the hand that we're holding.

You know, I'll just say like, you know, our outlook for this year, the guidance that we provided, and I'll frame this in terms of, like, 5% to 7% growth because I think--on operating income because I think that's the way to think about our business, we mentioned 3.5% to 5.5%, but that includes 150 basis points from Leap Day and VIZIO transaction. So, those are anomalous things. But the 5% to 7% growth I think is the right guidance for our business, given that we're three weeks into the year.

If the economy turns out to be, you know, maybe a little better than what we expected and we outperform and execute really well, then we should be able to overachieve that, just like we have in the last few years. But there's uncertainties right now, and I don't want to get--make some assumptions about what can happen when we're so early on into the year.

Bob
Okay. And, I mean, just double-clicking on that a bit, just the confidence in growing the sales by 3% to 4%, you know, and the ability and confidence in growing op income faster than sales, any more that you can add around those two?

John David Rainey
I am just as confident in doing that today as at any point in my tenure here Walmart. The--as you see from our results if--just looking at the fourth quarter, our business model is working. The team is executing on it. It could not be more clear to me the path that we're on.

As we've said repeatedly, it's not going to happen every quarter. In fact, the guidance that we would indicate for the first quarter would suggest that that may not be the case. But, you know, to think or to suggest that it can't sort of ignores the realities of running a business that's got a $700 billion top line.

Like, there's going to be things from one quarter to the next, investments or otherwise, that you need to do to manage a business of our size. But when you think about our business on an annual basis, on a multiyear basis, I feel really good about the ability to grow our profits, our operating income faster than our sales.

On sales, look, we're somewhat dependent upon other macro factors. Inflation would be one. And so--but if you look at what we've done over the last two years, we've outperformed those numbers, and everybody at Walmart here wants to outperform them this year as well.

Steph Wissink
Bob, it's Steph. And I would just add underlying that headline guidance of 3% to 4% are strong signals within the business in terms of health measures. Our traffic is growing. Our market share is growing. We're driving units. We're growing our reach across digital and physical.

So, I think when we look at the headline measure, it's really an output of all these input measures that are indicating to us that the businesses strengthening underneath. And that's what gives us confidence to start the year in a very similar place to where we have the last couple of years.

John David Rainey
That's a really good add, Steph. We actually just earlier this morning had our global leadership meeting with all of the officers at Walmart. And, yeah, they're--people are a little deflated when they look at the stock price reaction to yesterday. It's maybe not as unexpected for us that are closer to it, given where we guided to.

But the thing is like everybody here is energized. There's momentum in the business. The team, like, really did a good job in the fourth quarter. Like, if you go down virtually every operational, every financial metric, we exceeded what we expected in the quarter, which tells you how the team is executing here. And so, you love as a management team to have the stock price reflect that. But what we messaged to them is we need to focus on the things that we can control. And if we do that, the stock price is going to take care of itself.

Bob
Great. Thank you. The--I guess, you know, as we think about the business and the progress that Walmart has made, you know, globally, right, advertising, membership, Marketplace, fulfillment, I think you said yesterday that those alternative streams delivered half of the operating income growth this quarter. I think advertising and membership was more than a quarter of the operating income. You know, can you just talk a bit more where you feel like you've made the most progress, and then the largest opportunities in these? And I sort of want to click down a little bit more, but can we start there?

John David Rainey
Yeah. I'm happy to, but I'm going to rattle off a few numbers here because I think it's important to give you an idea of the progress that we're making. Advertising grew 29%. Membership was over 20%. Marketplace grew almost 40%. WFS, Walmart Fulfillment Services grew over 40%. We're really seeing good response, good growth in all of these areas of our business. It's hard to isolate one where there's more opportunity. I think there's so much runway with all of these.

Obviously, membership and advertising are having more of an impact on the bottom line right now. In terms of opportunity on the bottom line, I would say WFS is one that we still are expecting big improvements there. With any business, with any growth business, there's always this balance between driving growth and driving profitability. And I would say right now, in WFS, we're trying to drive growth. That's where our focus is. It's more balanced than some of the other areas, but they're all enormous opportunities.

Advertising is one that I think people quickly go to because of the margins in that business. But if you were to look at our advertising as a percent of GMV, we're roughly half, or less than half, what best-in-class opportunities are here. So we have an opportunity to continue to see strong incremental margins in this business from all of these areas. And the numbers that you quoted at the beginning are correct. If you take that basket of items that I just mentioned, the basket of businesses that I just mentioned, they accounted for 55% of the growth and operating income in the quarter. And just membership and advertising alone accounted for over a quarter of our overall operating profit in the quarter.

Stephanie Wissink
And Bob, I would just add, there was some confusion and follow up yesterday around the distinction between in the third quarter, we called out that those two businesses accounted for about a third and in this fourth quarter, we said about a quarter. That is also because the denominator in the fourth quarter gets bigger. So, it's less about a change in the cadence of those businesses, and more about the mathematics of the penetration rate. Those businesses are going to continue to drive about a quarter to a third of that operating income level each quarter. So, I wouldn't read too much into a directional trend in the change of penetration.

Kary Brunner
Also, the Big Billion Days will impact that a bit.

John David Rainey
Yeah. That's a really good point, the timing shift of Big Billion Days with our international business. With all these businesses, at some point, the law of large numbers, like, the growth rates are hard to continue to maintain as these businesses get bigger, but they are right now. We're seeing similar growth rates every quarter, quarter after quarter. We've consistently been in excess of 20 and sometimes 30% growth in these areas. So again, we're excited about how the business is transforming, and we think we have a ton of opportunity here ahead.

Bob
Great. And just if we could dig in a bit. Key drivers of future growth of Walmart Connect, can we talk about that one next?

John David Rainey
Yeah. So again, a big margin, accretive part of our business is continuing to grow. Vizio is one of the things that we're pretty excited about. Obviously, we have to absorb the transaction-related costs this year, but as we noted on the call, we expect that to become accretive next year. This gives us another channel to contact our customers and really better understand consumer behavior, consumer preferences, purchasing patterns, whether they're in store or in person. I'm sorry, or digital, in store or digital.

You can imagine surfacing an ad and streaming TV about a certain item, and then two weeks later, that very same customer goes into a store and buys that item. We have the lineage to basically connect that surfacing of that ad with the purchase point. And so, we're excited about what that can do to our advertising business. There's not a lot of other companies that have that ability to connect both the digital and the physical like we'll be able to.

Stephanie Wissink
Bob, it's Steph. I would add, we had our head of Walmart Connect at a conference about a month ago, and just summarizing how he characterized the opportunity in the business. He would suggest that we're really in the bottom part of the first inning, in the most mature part of Walmart Connect and we're just getting started in other areas, including things like on-premise, off-site, and Vizio, of course, an acquisition that just closed in December. We're very, very, very early in integrating that business into the overall Walmart Connect ethos of what we can offer to add buyers, to John David's point, and connect that media, and make it working media, traceable, working media that can help drive improved customer experience and outcomes for the ad buyer as well. So, I think we're really excited about the dimension that we're building behind Walmart Connect, and the unique position we have to connect across an omni channel customer experience.

John David Rainey
That's a really important point. I want to underscore it one more time. So said differently, we have both a growing addressable market here, so this can just get bigger as we grow our GMV, but our capabilities are also very nascent here. This is a newer area to us, digital advertising, and so we're getting more advanced, but we're nowhere close to where we expect to be. So, I think there's a ton of opportunity here.

Bob
Great. If we could sort of jump to advertising, the advertising outside of the US. Flipkart has a big advertising business. Is it a similar opportunity for what you just talked to? Can we talk a bit more about that?

John David Rainey
Yes, it is, and we're even further under penetrated there right now, when you look at advertising as a percent of GMV. I think that's an exciting opportunity. And I wouldn't miss PhonePe either. PhonePe has got--they've got a growing commerce part of their business, which provides opportunities for advertising. What's exciting about PhonePe is, just to back up for one second, they have 100 million daily active users, 100 million daily active users. Think about the engagement opportunities that you have in a vertical like that. It creates tons of opportunities. So, when we talk about our advertising opportunity, we're not just focused on the US, we're focused on our international segments as well.

Bob
Great. Can we just touch on membership a bit? I guess, two topics in membership. The first one for us would be just trends of Walmart Plus, the customers there and sign ups versus usage and frequency. Are they predominantly higher income customers at this point? And the second one is just membership trends in Sam's, and anything on Sam's you'd be prepared to talk about would be helpful. Thanks.

John David Rainey
Yeah. Tell you what, I'll take a stab at Walmart Plus, and I'm going to ask Steph and maybe Karry to jump in on Sam's, some really encouraging trends there. Walmart Plus, we grew both income and members, double digits. Really pleased about what we're seeing there. I think the value proposition continues to improve, but not just because we're adding amenities to that. We're actually getting better at the basics, at delivery, at fulfilling orders when people expect them. We can talk more about that later if you have a question on that, but I'm quite excited about that.

It's it does skew a little more towards higher income households, but it might surprise you, it's maybe not as much as what you think. We have a lot of low and middle-income households that avail themselves of this. And you can imagine, even with our lower cost here on this, there are some people that don't have cars, that rely on public transportation to go to the grocery store. And so if you think about being able to pay a small fee each month to have that delivered to your house for free, that's a pretty compelling value proposition. And so it's not as skewed as what maybe you might think when you look at the dispersion across income cohorts.

Stephanie Wissink
And Bob, it might surprise folks to know that our single biggest acquisition channel for Walmart Plus is to have two successful online pickup and delivery orders. It's not advertising or social media marketing campaigns. It's actually a great experience, and so we continue to see that as our top of funnel. And to John David's point, executing on the basics exceptionally well is our single biggest motivating factor for someone to become a paid member. So, we're going to continue on that pathway of continuing to reinforce capacity, commitment and the promise of delivery in a fast speed across a broader range of assortments. It's really very much tied together with membership.

John David Rainey
Can I say one thing before you talk about Sam's? One of the things we're excited about, as you know, or as you may know, we're in market with an RFP for a credit card since we've terminated our agreement with Capital One, and really looking forward to an enhanced value proposition around our Walmart customers and Walmart Plus customers in terms of cash back rewards. And we think that that could be an enormous acquisition channel for new members for Walmart Plus, so excited to talk more about that. Maybe we'll be done at Investor Day. We'll see, talk about it then, but certainly you'll hear something later this year. You want to cover Sam's real quick?

Stephanie Wissink
Yeah. I think Sam's is an excellent story around how we're thinking about a member value prop. The team has invested behind the value proposition. You're seeing that even in the fourth quarter, when we made a wage investment, and we know that associates are an incredibly important part of how our members experience our club and our brand. There's a direct correlation between associate investment and associate job satisfaction and member retention and acquisition, as well as renewals. And so that's a really interesting observation of the club's business, that your associates are representatives of your brand to your member base, and it does drive renewals and acquisition.

A couple of just call outs for Sam's. I would say one is that the biggest cohorts that we're seeing in terms of growth are in millennial and Gen Z, which is a really interesting health metric. If you think about Sam's membership base, we're acquiring these customers early in their life stages, and so they're tending to spend more earlier than maybe a natural, historical membership advancement would. We've seen Plus penetration rise. We've also seen double digit growth overall in membership fee income. So, I think all of the health measures of membership at Sam's would suggest that the segment's on its way to continuing to grow membership at a pretty high rate.

Bob
Great. Just a couple of questions now on long-term drivers. E-commerce, is e-commerce close to profitability? Are delivery costs the swing factor for US e-commerce? Is the timeline for profitability still 12 to 18 months? I think you had said that in June. Is that still the case?

John David Rainey
I think I'd like to hold what I say on e-commerce, profitability to maybe later this year, maybe Investor Day, but we're feeling really good about the trajectory that we're on. I said at our shareholders day last year, that I expected within the next year or two, that we'd be profitable in e-commerce on a global basis. And it's likely going to happen this year. I think we're pretty close. And look, we've given enough data points out there for, I think, people to figure that out.

We said that we had an 80% improvement in losses in the US business. You've continued to see our delivery costs come down. But some of the improvements here, because we're so early on into some of this stuff, that they're kind of almost like step change improvements. And particularly when I point to delivery costs, we figure something out, and then we roll that out, and you have a bigger change. But we just continue to be really pleased with what we're seeing there.

I talked about the incremental margins in the business on e-commerce. They were 11% for the enterprise in the quarter. They're 14% in the US. And again, it's not going to be that rate every quarter, from one quarter to the next. It may go down or go up, but you can probably deduce that we're getting pretty close to being profitable there but really excited about that part of our business.

Stephanie Wissink
Bob, I would add, the pride in the organization around that milestone is really, really high. And if you think of the degree of difficulty that we operate under versus some of our larger competitors, our general merchandise penetration is far, far lower, which is a great opportunity for us to think about transaction level margin. But the degree of precision that we have to have in our delivery capabilities to deliver perishable items to someone's doorstep, it can't just be a six to eight-hour window. We're not going to put a bucket of ice cream on your front doorstep six hours before you arrive home. So, the precision built into the model around delivery is exceptionally high. And I think we're really proud of the fact that we can do this with a food indexed business, knowing that the general merchandise opportunity is in front of us, and that's where a lot of the transactional margins exist.

John David Rainey
Yeah. If you can imagine a graph in front of you that's got two lines on it. One is our e-commerce GMV, going up into the right and the other is the profitability of the e-commerce business. For many years, those lines were diverging. As one went up, as we grew more, GMV, the losses only increased. Right now, those lines, and in fact, for the past several years, those lines have been going in the same direction. And so we talk about densification of our network a lot. That's a big

driver of this. As we grow GMV, because the contribution profit is positive in this business, we're continuing to see those losses minimize, and we'll soon enough get to a place where we're profitable there.

Bob
Great. I guess, just supply chain, automation, robotics, do you have a status update on this, and I think the micro fulfillment solution? What's ahead of schedule, behind schedule? Any color around that?

John David Rainey
Yeah, I'll try to be quick here because I know we're getting longwinded on our answers and running out of time, but continuing to make good progress on the automation. We've got 55% of our fulfillment center volume is automated right now. We have 2,300 stores that are served by some form of automation. And in probably 75% to 80%, we call it roughly 1,800 of those stores, the degree of automation is significant enough that we're seeing improved productivity in the stores. And so, we've talked about there's not this exact linear relationship with the degree of automation and the productivity benefits. We need to have a certain amount of scale to really achieve some of the productivity benefits across the organization, and we're really starting to see that now. It'll be more pronounced next year but quite encouraged by the progress we've made here.

Stephanie Wissink
And, Bob, on the micro fulfillment solution, you may have caught the headline that we are not outsourcing that automated storage and retrieval at the site level to a partner that we're using in our ambient network called Symbotic. That's a new structure that we have in place where they're going to take on the development of the software and the build out of the hardware, and then we can accelerate that footprint development. And so, we're excited about getting that into the hands of somebody that can escalate it pretty quickly and putting a commitment behind getting some of those what we now call kind of local pick up and delivery, automated pick up and delivery locations appended to some of our high volume stores.

Bob
Great. If we could jump to I think CapEx -- I think CapEx 3%, 3.5% of revenues, is that the right run rate going forward? But there appears to be a big -- a bigger focus now on new store growth again globally - I think maybe this is the most in a decade, Canada, Mexico, China, even in the US. Can you talk about these investments and the drivers?

John David Rainey
Well, if we back up a second and you just think about the last five years, we've grown revenue -- someone could correct me, but off the top my head, about $160 billion and really without adding any meaningful number of stores or clubs. And so, there's an added story here about asset utilization, asset turnover that I think is helping to drive some of the ROI improvements that we're seeing.

But when you've got the model figured out, when you're seeing the response from customers, I think that gives us a little bit more license to go out and add some stores. And so, you're seeing that that's in our plan with both clubs and stores. And we're quite excited about some of the areas that we are adding them.

Think of our CapEx as roughly kind of rule of thumb this year is probably 60% is going to be supply chain automation as well as remodels and new stores.

Bob
Okay. ROI, the -- ROI I think was up 50 basis points, and that was last achieved, that level in 2016. What are the biggest drivers around ongoing improvements in ROI over the next few years from where we are today in the buckets maybe?

John David Rainey
The biggest drivers will be the continued growth of these newer businesses that we've talked about - advertising as an example - and also the productivity benefits that we expect in our fulfillment and distribution centers as well as stores related to this automation.

Bob
Okay. Capital allocation is my second to the last question - 13% increase in the dividend, largest in a decade. What were the largest considerations to that increase versus the buyback? And I think you also said more buyback in '26 than '25?

John David Rainey
So last year, we increased our payout ratio to 37.5%, and we had a pretty sizeable dividend increase there. We kept the payout ratio the same this year and increased the dividend in line with earnings last year; resulted in the 13% increase - as you noted, the largest in over a decade. I think it reflects the confidence that we have in the future of our business and its ability to continue to generate free cash flow at these levels or higher.

So, we'll give a little more color on how we're thinking about capital allocation at our Investor Day in April, but we want to be balanced here. We -- as I noted on the call yesterday, we've got a great opportunity to invest in ourselves in some of these projects that are returning 20%, IRRs; supply chain automation would be an example. So that that's priority one, but we also want to return cash to shareholders. We'll do that through dividends and through share buyback.

Last year, we allocated a little bit more capital to other sources besides share buyback. This year, we intend to be a little more aggressive there. And, look, at what's going on in the stock market, too. We see the dislocation in our stock price. We have all the conviction that we've had before related to our long term opportunities. So, we're buyers, and you could expect us to be more aggressive because of that.

Bob
Great. And my last question for you is the tone on the call yesterday, the live call was quite optimistic - stock down a little bit yesterday, a little bit more today. Can I finish by asking like what you are most excited about with the strategy and the outlook for the business today?

John David Rainey
I'm excited the strategy's working, and we're growing and digital channels. Our customers and members are responding. It's resonating with the [customer]. And it's resulting in improved financial performance. And so you are right to note the positive tone on the call. We don't -- we're not blind to what -- movements in stock prices, but we're very focused on what we can control. And where -- the team is executing here. We think we've got the right strategy, the right tailwinds to the business and a right to win in a lot of these areas that we're playing it.

And so, we're really excited about the business going forward. The outlook that we provided I think is responsible for the macroeconomic backdrop that we have, and given that we're so early into the year, we would certainly hope to outperform that. But it's not an overstatement to say that I could not be more excited about our business today than at any point during my time here. In fact, we now have data points that are validating many of the things that we've talked about over the last couple years. And so, we're starting to put our foot on the accelerator and excited to see what that holds?

Bob
Great. Do I have time for one more?

John David Rainey
Sure. That was such a good close, though, Bob.

Bob
Hopefully I stay in line.

John David Rainey
Yeah.

Bob
I guess just on SG&A, can you spend a little bit of time on the SG&A outlook? I think you're targeting 20%. But can you get there with ecommerce growth pressuring SG&A? Can we just talk about that maybe as a close?

John David Rainey
Yeah. So I talked yesterday about the fact that, when we sell a digital item and deliver it to someone that the SG&A related to that is going to be higher than if someone walks into a store

and pulls it off of a shelf, the gross profit is also higher, too. So as our business changes, I would encourage people to really focus a little bit more on operating income where all of that nets out. It's tough to say what happens and when because I don't know -- I can't predict perfectly what the channel mix is in our business five years from now, but we know that we have an opportunity to lower cost. We know that AI is going to help us do that. And we're very focused on that.

I think it's reasonable to assume that we can get back to a 20% SG&A even with the channel mix that we expect. I've also said consistently before it's a little bit of a stretch for us. When you -- like basis points on a $700 billion business are a lot of dollars. But I also don't think that we fully have captured or appreciated the opportunity that AI presents over the next several years.

So, I'm optimistic that we can do. We have a person that reports to me now that they wake up every day and their job is EDLC. They're focused on what are initiatives that we can drive to try to see improvements in both how we operate as a business, but also the cost structure of the business, as well.

Bob
Great. John David, thank you very much. Steph, Kary, all my client friends on the call, I appreciate the time. It was very helpful to us. Have a great weekend, and go Baylor.

John David Rainey
All right, thank you, Bob. Appreciate it.

Bob
See you guys.

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