Walmart
Q2 FY25 Buyside Investor Call
August 16, 2024

Presenters

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Q&A Participants

Mike Baker - D.A. Davidson

Operator

Greetings. Welcome to Walmart's Second Quarter Investor Call. At this time, all participants will be in listen-only mode. If anyone should require operator assistance during the conference, please press star zero from your telephone keypad. Please note this conference is being recorded.

I'll now turn the conference over to Steph Wissink, Senior Vice President, Investor Relations. Steph, please go ahead.

Steph Wissink

Thank you, and good day, everyone. Appreciate you joining our call today. This call is being recorded, and 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 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.

Michael, I'm going to turn it over to you to kick off.

Mike Baker

Great. Hi, everyone. I'm Mike Baker. I'm one of the consumer analysts here at D.A. Davidson. Thank you for joining us for this call with Walmart's CFO, John David Rainey. By way of format, we have 45 minutes. I will lead a Q&A session.

I'll be touching on a lot of the issues that were discussed on the call yesterday, but hopefully the goal here is to ask questions in a way that will help bring out some incremental information, or at least think about what was said yesterday in a different way. And in other--I guess in other

words, I'm presuming that folks on this call listened to the call yesterday, so hopefully this won't just be a reiteration of that.

So, with that said, I'm going to jump right in. I got about 10 or 11 questions over 45 minutes. At the end, if we have time, a couple rapid fire ones. But, John David, I guess I'll start off very high level, open-ended question. What's your view of the overall consumer economy? And the reason why I ask it is it seems to be different than what others are seeing.

Prior to yesterday, it was almost a foregone conclusion that the consumer was slowing. Then all of a sudden, you put up a good number. And the retail sales number, you know, the government sales statistics, come out and that looks good. And then all of a sudden, the headlines are the consumer's resilient, which was completely different than what people thought on Wednesday.

So, you know, maybe it's a tough question for you to answer because I'm not specifically asking about what you are seeing from your customer. But what've your view on the overall consumer environment in general, understanding that you're probably taking market share?

John David Rainey
Sure, Michael. Look, we--we're attentive to all the economic data that the listeners on this call are looking at. And certainly, when the jobs report came out, that caught our attention. We closely looked at the trends in our business, and there was a little bit of a disconnect between the jobs report and maybe more specifically the overall sentiment in the market and what we are seeing in our business.

And just to be clear, in our business with each month of the quarter, they were fairly consistent. If you were to get pretty granular, July actually had the highest comp. We think that that's largely attributed to the way the days fell within--the days of the month fell within the last week. And when you normalize for that, it looks pretty similar to the other months.

But we clearly weren't seeing any, as I described it, additional fraying of consumer health. But we also do our diligence. We talk to other economists at large banks to make sure that there aren't trends that they're picking up that we are missing in our data. And so, I'd describe it as consistency. They're still--we're seeing behaviors with customers that are still showing signs of dollars being stretched. They're being choiceful, discerning, looking for value, focusing on essentials, but there hasn't been any incremental weakness relative to what we've seen in prior quarters.

Mike Baker
Got it. Okay. Thank you. The--now, the other big topic I think, that, you know, was talked about a little bit about yesterday and we're hearing from others, in fact I saw a headline from Kroger today relevant to this, I wanted to ask you about pricing, competitive pricing in food, in consumables. What are you seeing from other retailers with respect to their pricing strategies?

Many have acknowledged to being more competitive on price. How does Walmart react to that? You've talked about being pleased with the price gaps. If--I guess if I could dig into that a little bit more, what does pleased mean? Are the price gaps getting wider, narrower, etc.? Just a little bit more color on the pricing. Thank you.

John David Rainey
Price gaps are consistent with where they've been for several quarters now. And we say we're pleased with it, or we like it because we're seeing that we're gaining share. I don't think that's all because of price. Certainly, we'll talk about the convenience element of that at some point in this conversation, I'm sure. But we're gaining share in all categories across all income cohorts.

And so, we like where our price gaps are. It is a competitive environment. It always is. And we've learned in into certain areas with rollbacks. We've noted those are up year-over-year quite substantially. We're eager to get through the back-to-school season and into the holiday season, the more seasonal periods that our customers have shown a willingness to celebrate. So, we like where we are, but we'll be very attentive to the overall macro landscape around pricing.

Mike Baker
Okay. And if I could just follow up on that, you know, I think--like I said, Kroger was on the headline today. They're lowering prices. At least five or six public retailer--public grocery retailers that have said they are lowering prices. But are you seeing the environment get sharper overall? I think some of those declines are maybe more temporary than a rollback, as an example. Like, in your mind--or it feels a little bit as if we might be getting into a price war, but maybe not. That could be overstating it. Again, just a little bit more color on overall pricing in the industry, in your opinion.

John David Rainey
I think pricing has been pretty rational. I certainly don't see a price war coming, but it's always difficult to predict the future. We see that there are categories with certain retailers that are, you know, those items that lead people into the store where they're becoming more price competitive with certain retailers. And we're trying to provide value and advocate for our customers where we can across the shopping cart. But it feels like a pretty rational pricing environment to me.

Mike Baker
Okay. That's helpful. And I'll editorialize that we put out a report this morning on pricing, and I would tend to agree with you. Pricing does seem to be pretty stable.

The--one sort of last one maybe along the same lines but a little different is, as inflation has waned, how have your conversations changed with vendors with respect to pricing? We know you've done rollbacks. One thing I noticed, though, is you talked about the growth in rollbacks.

It was 35% this quarter. The previous quarter was 45%. The quarter before that, it was 50%. One might read that into, you know, being less aggressive in price because, you know, the growth in rollbacks is decelerating. But I don't think that's the right--you could, you know, sort of explain how--what are your vendor conversations like, and why would the growth in rollbacks be decelerating?

John David Rainey
I think it's really simply lapping a more elevated level of rollbacks in prior quarters in the last year, and so kind of law large numbers. We're being aggressive on rollbacks. We're seeing that that's driving some of the unit growth and share gain that we're enjoying, and so we want to continue to do that.

In terms of conversations with vendors, we've certainly really pushed hard, and we've seen some vendors respond in kind with trying to lower price. Not all of them have, as Doug noted on the call yesterday. But this is where, with a comprehensive private label offering, we can offer our customers and members an alternative, and we're seeing them respond.

Private label for us in the quarter was up over 50 basis points again. We've got a much broader assortment, a better assortment. We've called out the fashion brand, No Boundaries, as well as bettergoods that we've launched. We're really pleased with what we're seeing around that. And so, our customers and members have alternatives in the face of higher prices. And so, we'll continue to advocate for our customers, whether it be with vendors or the own offering--the offering that we provide through our private brands.

Steph Wissink
Michael, it's Steph. If I could just add, and this is a technical response, but just recall that, as a rollback becomes effective in the market, a supplier may elect to make that rollback a permanent price revision. And therefore, it would be no longer called a rollback. So, the price may be coming down on a permanent basis. It's still value to the customer, but it wouldn't be technically defined as part of that programmatic volumetric driver, which is our rollback program.

John David Rainey
That's a really good point.

Mike Baker
Understood. So, in fact, maybe because--that deceleration actually gives the opposite answer, that there are fewer--there's less growth in rollbacks because more of those price declines have become permanent.

John David Rainey
Exactly.

Mike Baker
Is that the--is that sort of what you're saying? Okay, interesting.

John David Rainey
Yeah, exactly.

Mike Baker
Makes sense. Okay. Okay, I think that's good on pricing.

Let's talk about your market share, some of the drivers of share gains. And this will probably lead into what you referred to earlier as the convenience type of thing. But--so, your comps are 4.2% in the US this quarter ex-gas. That's faster than the industry data we look at, NAICS 4-52, sales for general merchandise stores. That was up 2.8%. I think even faster in each of the last seven quarters. You're clearly taking market share.

One of the debates and things that I think people are talking about is, all right, is that--how much of that is because of your value positioning? In some ways, okay, it makes sense that Walmart's taking share in this environment. But how much of that is because of--you know, it's impossible to specifically separate. But qualitatively, is this price, or how would you characterize the improved customer experience, you know, in terms of assortment online and in stores, convenience, etc.? Any way to disaggregate where you're--why you're gaining so much market share right now?

John David Rainey
Certainly, customers are looking for value, and we believe that we're gaining because of that. But it's helpful to look at in-store versus e-commerce. And certainly, we see an outsized contribution from our e-commerce growth, which I believe really speaks to the fact that customers are coming to us as much for convenience as they are for price. It's the whole omni model.

Another thing that I pointed to on the call yesterday was some of our delivery statistics. So, if you think about our e-commerce business, just using rough math, it's split pretty equally between store pickup and delivery. Of the scheduled delivery, fully a third of customers right now, 30% to be exact, are taking advantage of this express shipping or express delivery, within an hour or within three hours. And that's something that they pay more for.

That number, that 30% number, a year ago was about 10%. And so, we continue to see that customers are taking advantage of the offering that we have around e-commerce. And so, I think this is very much related to us being more convenient, us fulfilling these orders better. And that's driving it every bit as much or more than value.

Mike Baker

Yeah, that--you know, that actually dovetails well into my next question. And within e-commerce, I did want to ask you about the uptake of that premium delivery service, that 30% number up from 10%. So, that's a new number, that 10%. I guess, you know, why has it grown so much in just a year? Are you marketing it more? I mean, it seems like as the economy has gotten tougher, that that would--that wouldn't necessarily increase. So, I'm curious about that.

And then, you know, is that--I know you talked about consistency across income cohorts. And I'm wondering, is--that uptick on the premium service, is that more, you know, a sort of $100,000 household and higher type of thing, or how is that--you know, what does that look across income cohort?

John David Rainey
Sure. Well, first I'll say, Michael, the uptick, I've been pleasantly surprised with the number of customers that are taking advantage of that. Those that are in our business that are closer this maybe aren't as surprised as me. But that's a pretty large number, to have almost a third of your customers that are taking advantage of this and paying for an expedited e-commerce delivery.

It is distributed pretty equally across income cohorts, which is, again, maybe a surprising indicator. But when you think about, if you're making dinner this--tonight and you need certain ingredients and you want to have them delivered to your house while you're at work or, you know, right before--right when you get home, there are not a lot of e-commerce digital players that can do this in the way that we can.

And it is--it's also another data point that I think is a little counter to this narrative about a weakening consumer. If dollars are being stretched more and the consumer is fraying, then this would seem to be a nicety that you wouldn't see the increase in. So, we've been really pleased with this.

And this is muting some of the costs that we have around e-commerce and helping with the e-commerce improvements in profitability, and maybe I'll spend just a second on that. I talked about this on the call yesterday. But if you go back over the last several quarters and you tend to parse out the various buckets of your business, advertising's an obvious one, membership is another, Fulfillment Services, I can go down the list, and look at the contribution of each of those to our profit, the single biggest contributor to our profit improvement year-over-year was just core e-commerce business, excluding advertising, membership, all these other areas.

So, we're really pleased with that. We noted on the first quarter call that the incremental margins in e-commerce were about 12.5%. And I said at that point in time that we expected that to be a high point for the year and it would probably decline because some of the improvements that we made around delivery cost and things like that, it would be tough to continue to make those same level of magnitude improvements.

Well, we did it again this quarter. Our incremental margins this--in e-commerce this quarter were double digits again. They were 11%. And again, we had another quarter of 40% improvement in delivery cost. So, we really like what we're seeing in terms of the economic profile or the improvement in that in our core e-commerce business. And that's why when, you know, we made some comments--Michael, you were at our Shareholder Day when I first made a comment that we expect to be profitable in e-commerce in the US in the next year or two. I have a high degree of confidence of that.

That--this is not something that we think is elusive. It's simply a matter of time. And we'll achieve that, as Doug said, and move past that and probably quit talking about it. But it really speaks to the earnings power of the business when you're generating double-digit incremental margins on a business that is growing north of 20%. You can just see, when you combine that with advertising and Data Ventures and Fulfillment Services and all these other faster growing, higher-margin parts of our businesses, that the enterprise operating margin wants to go up in our business.

Steph Wissink
Mike, it's Steph. I would just add two things on delivery specifically. The first is that delivery is one of our single biggest channels for acquisition for Walmart+ members. A successful delivery experience or a pleasant delivery experience where we're hitting that perfect order is a very important driver to building membership and relationship with that customer.

The second is that, when we look at our customer insights work, the express delivery is also one of the strongest points of advocacy. So, we're not doing heavy marketing around this. A lot of this is word-of-mouth, organic, customer to customer influence. And that has also been very disruptive and productive over the course of the last year. So, you asked about 10% to 30%. This is largely organic, and it's driven through execution and advocacy.

John David Rainey
The other thing, and I know we're really hitting on this point, but I think this is such an important part of the story of the quarter, but it drives frequency with our customers. And when you look at the Pareto of our customer base, those customers that shop us weekly or every two weeks versus everything else, we've seen a significant increase just in the number of unique customers that are now shopping us once a week or once every two weeks versus where we were even a quarter ago.

And it's, I think, because we're doing a good job here. And please don't just take our word for it. The NPS scores around this continue to increase. So, we're quite pleased with the execution and the improvement in this part of our business.

Mike Baker
Any desire to quantify the NPS scores, or even, you know, what percent of orders are perfect deliveries versus perhaps a year ago or something like that?

John David Rainey
We haven't quantified them. But a perfect score--and correct me if I'm wrong here, Steph. I think it improved 300 basis points, or perfect order improved 300 basis points in the quarter. That's down a little bit from the really significant outsized growth we had in the last quarter. But we continue to improve here.

And look, we have a whole lot more room to grow, to improve here. I don't want to suggest for a second that we're close to being perfect. We know our weaknesses. We have a laser focus on addressing those, whether it's the number of boxes that it takes to fulfill an order and the number of deliveries to your house, or many other aspects of our delivery business. And that's what the team focuses on, and you can see the result of that focus over the improvements we've made here over the last two years.

Mike Baker
Yep, yep. It makes sense. My pet peeve, I'll--just personal anecdote is, not from you guys, from others, when you--well, it's really my wife. When we order something for delivery and it has a low-fat product that she orders, and then they substitute a non-low-fat product. Like, well, what's the point of that? It might taste better, but there's a reason why someone orders low-fat, I guess.

John David Rainey
Yeah, and it's not a good experience. And I'll share some inside baseball here. So, John Furner, who runs our US segment, has had all of his direct reports go out and work in a store and fulfill an e-commerce order in the last month so that they can see the challenges that some of our associates have with doing that.

And so the management team is quite focused on this, and it is challenging sometimes. We try to provide an automated next best offer on things that maybe we don't have in stock, but sometimes it does require a little bit of discretion on the part of the associate. It's not 100% automated, and that's where you get the type of experience that you just described, which many of us have probably had. You don't want to have an item that's substituted, and if you do, then you surely want it to be something that you want in return.

One of the things that we're also doing, like in our Canada business, I was in -- Steph, and I were in Toronto about six weeks ago, and when a customer places an order, we have a way of categorizing that customer. We can -- we'll know that they're a Walmart+ customer, they're a first-time customer, and we have a way of denoting that they're a VIP customer as well. And VIP for us is someone that gave us a low MPS score on their prior visit, and so we know that this person has given us another chance. We need to get it 100% right. And so, this shows first of all, the level of granularity that we have in the data around this and how we're serving our customers, but also the focus that we have on improvement in this area.

Mike Baker
Yeah, that's interesting. That's so counterintuitive and interesting in telling that the VIP customer is the low scoring ones. By the way, my wife would kill me if she knew I told. If anyone sees her, don't repeat it.

Let me ask you this. I was asked this a couple times yesterday. What happens in a better environment to the extent that the consumer behavior is being driven by value right now, any insight into how your business would react should the overall consumer spending and retail sales environment get more robust? You know, I know you've seen this. Well, not you, but institutionally, the company has seen it millions of times. Bad environments go into good environments. What have you seen in the past? But why might it be different this time because of some of the strategies you guys have in place?

John David Rainey
I appreciate the question because I think there's a narrative among bears out there that is suggesting that maybe our share gains or our winning right now is because of being in a more challenged environment, and certainly we'd all recognize that we are benefiting to an extent, but I don't subscribe to that narrative. I go back to some of the improvements that we've made in convenience and how that's resonating with our customers.

And as you know, convenience matters to everyone, irrespective of their income level, irrespective of what's going on in the economy. Time is our most precious asset, and we all value that the most. And so, I think we're going to continue to do really well here.

The other thing that is worth noting, we've had quite a significant head wind on our margin because of the mix shift in our business. And so, as we get to maybe a better economy, more expansionary economy and we see a shift back into general merchandise, we're going to stand to benefit on our overall gross profit or gross margin from that. We've kind of glossed over that point, but that's been a pretty significant headwind for us over the last several years that at some point is going to revert and become a tailwind.

The other reason that I feel pretty good about that is our expanding assortment, particularly in general merchandise. We did not provide figures on this call around the growing number of sellers on our marketplace or the growing assortment on our marketplace. We'll probably share that in the next quarter or two because we've made really good progress. But when you look at categories like fashion, toys, hard lines, home, these all comped on our marketplace over 20%. Customers are responding to the assortment that we're providing, and if we get into an environment where we have a tailwind related to spending, I think we're going to stand the benefit there.

Mike Baker
Yeah, you didn't quantify it that the number of resellers this quarter, but I think last quarter, you said 420 million, and that's up pretty dramatically from where it was. It just --

John David Rainey
Yeah, well, we're up appreciably from the 420. We'll disclose what that figure is in the next call probably.

Mike Baker
Okay. All good. It is something I track. So, I look forward to hearing that number. You know, the mix -- great point in the mix, if I could follow up there. I think for a while you were quantifying the mix impact, I believe. I don't remember hearing it this quarter or maybe even last quarter. Anyway, any way to quantify how much you think that mix has hurt your margin over the last two years, or anything along those lines.

John David Rainey
Well, I'll let investors and analysts do the math on what they think the margin impact is. What I can tell you is that our expectation for this full year remains as it was at the beginning of the year where we think that we're going to have a head wind of about 80 basis points of shift from the GM category for the year.

Mike Baker
Right. Okay, that's what I'm getting at. Okay. Okay. Fair enough. Excellent. Thank you. All right. Now I wanted to get into some CFO questions, I suppose, not that those weren't CFO questions, but more specific member type questions.

I wanted to ask about your guidance -- your back half guidance. And I think, you know, people picked up, and I've seen it in the popular press and all that, CNBC, that you did increase your full year guidance, but only due to the first half. The back half outlook is unchanged, correct me if I'm wrong, from six months ago. So, after two quarters of better-than-expected trends, why would the back half not be more optimistic? I think on the call you did talk about having data on past elections. I don't know. Can you share any of that data? Do elections actually impact your business?

John David Rainey
Most normal elections don't have any pronounced impact on our business, but to address the question of why leave the back half unchanged when we've outperformed to such a great degree on the first half. Look, I called out on the call, there's reason to be guarded or measured in the outlook. We've got geopolitical unrest in the Middle East. We've got an election coming up that is another pretty divisive one in the United States. You don't know how that's going to land and what the reaction to that will be. And again, just a week ago, we had a jobs report that came out that was a little concerning to people.

So, we don't want to get out over our skis. We like to hit the top end of our guidance, and we want to continue to do that. But we're not immune to some of these swings in economic activity, and this has been far from normal times from forecasting. I feel like we've been saying

that for three or four years. Would love to get back to a more stable environment. But unfortunately, that's not where we are right now. I think we're, you know, at a little bit of a pivotal moment in terms of how the economy can move here, and so we want to be measured in that outlook.

We feel really good about our ability to execute on what we can control, but we're not completely immune. And it's probably worth just -- if you allow me to take a step back here for a second -- just on guidance and performance overall, we've had several successive quarters here of outperformance. Certainly, everyone can appreciate not every quarter is going to be like that, and there are going to be quarters that are maybe a little underwhelming. We're managing this business over the long term and trying to make the responsible investments to allow us to achieve the outcomes that we laid out to the investor community.

And so, you know, there's going to be some bumps in the road, a hiccup here or there. Not -- and I'm -- please don't read in between the lines on this. I'm not trying to hedge any of the guidance that we put out there. That's not what I'm saying. But, you know, you just have to expect in running a normal business that you can't have everything up and to the right, like we have for the last couple quarters, every single quarter. And so, our guidance takes that into account.

When we when we look at our guidance, we always have what our forecast is, and then there's the risk and opportunities, and we try to have those relatively balanced. These are the things that aren't in our forecast, but could impact the numbers, and it could be an accrual here, or shipping costs there, whatever it is, and we've been in an environment for a few years where there's been a lot more risk to the business than what perhaps normal times are. And so, we feel good about our guidance. I think it's the responsible guidance for our business, and we look forward to being able to outperform that as we get through the back half of the year.

Mike Baker
Yeah, and the recent track record is certainly -- has certainly shown that. Okay -- so and then -- thank you for that answer. And then cutting it even one step further. Can you remind us about the third quarter outlook versus the fourth quarter? I think the third quarter profit margin is closer to, you know, the implied profit margin is closer to flat at the midpoint, if you look at the sales and profit guidance. But the fourth quarter is -- looks for growth on a year over year basis. So, on the call, you talked about some events in your international business. You also talked about some expense timing issues. I wonder if you could flesh those out a bit. How much can this shift in big billion days impact margins? And any way to quantify it or what order of magnitude? And then, what are the different expense timing? What and why are the different expense timings in the US? Thanks.

John David Rainey
Sure. If you took the midpoint of our sales and operating income guidance, it would suggest that we're not going to have operating income outperform sales in the third quarter. If you

remember, we actually called that out as a possibility in the first half of the year as well, and we were able to outperform our own expectations. I hope to be able to do that again in third quarter, but our forecast internally reflects what that guidance suggests. And so, we think that there's a possibility that sales micro faster than operating income.

It's in large part for some of the reasons that you mentioned, Michael. We have, you know, our international business is a growing part of our portfolio, and there are markets there that change the timing of some of their bigger events each year. Big billion days with Flipkart is an example of that that can vacillate from third quarter to fourth quarter back to the third quarter, one year to the next, and that impacts the timing or the margin performance year over year in our third quarter guidance. Flipkart is not currently a business that makes money in eCommerce. I think we've been pretty transparent about that. And so, when they're in a period where they might have more sales, you're actually gonna have more pressure on operating income. And so that's reflected in our guidance.

The second piece is that we've got on balance a little bit more investment in third quarter. This is largely related to technology type investments to enable or accelerate parts of our platform. So relative to the fourth quarter, we've got third quarter is a little bit more of an investment quarter. We want to put ourselves in a really good position for the holiday period.

Steph Wissink
Again, I would just add too, marketing has been a very productive investment for us in the second quarter. We're going to carry that posture into the third quarter as well. We've seen the sales, particularly in general merchandise areas, respond to that marketing investment in the Walmart US segment. So, you'll see that as well. And that's a timing effect. We're gonna kick that off in the third quarter, as we did in the second quarter with back to school.

Mike Baker
Sorry. So, can you explain that again? So, you get, you did it in the second quarter, but you're gonna, -- you just said you're gonna kick it off in the third quarter, meaning you're gonna sort of re-kick it off, like another sort of round of that advertising campaign?

Steph Wissink
Yeah, related to celebrations like John David is mentioning. So, the timing of celebrations is a catalyst to kick off marketing and to really introduce the customer to this wide assortment that we have, in general merchandise in particular. So, think of this as a general merchandise accelerant, and we're seeing a productive response to the marketing campaigns that we've deployed in the second quarter for back to school, and we'll do a similar kind of kick off to holiday in the third quarter.

Mike Baker

So, two follow ups, if I could, one, moving up the timing of the IT spending. Is that so that whatever you're spending on will be in place for the fourth quarter? Or is it that you just don't want to disrupt during the fourth quarter? That's one follow up. Sorry.

John David Rainey
Well, it's some of both, we have a freeze that we do with our technology team during the important holiday period where we don't want to be issuing code into the market when -- during our busiest shopping days. So that's part of it, but part of it too is to our investments to actually be able to realize some of those benefits, not just in the fourth quarter, but going into next year as well.

Mike Baker
Yeah, we don't -- we got to be careful about those code things, we all learned last month. The -- one more follow up on the marketing. So, you obviously disclosed your advertising and marketing costs on an annual basis in the K, not quarterly, I don't believe, but -- so is the marketing spend up appreciably? Is that any way to -- I don't know -- any color on increase in marketing spend?

John David Rainey
I wouldn't say it's up appreciably. On the margin, it's up a little bit. But the way that we look at this is we scrutinize the return on advertising spend to make sure that we're driving the types of returns to do this. And this is, as Steph mentioned, it's a more variable type marketing expense that we have the ability to calibrate or flex a little bit depending upon particular initiatives that we may be rolling out during that period of time.

Mike Baker
Got it. Makes sense. Thank you for that follow up. All right. Another sort of quantification, just the math and how impactful your alternative business -- your alternative businesses are with respect to the operating profits. I think in the first quarter, the operating profit depending on if it's constant currency or not was -- grew somewhere in the $850 million to $900 million range. And you said a third of that was from the alternative businesses.

I don't think you quantified it on the public in terms of the percent of the $550 million adjusted operating profit increase in the second quarter. How much of that was from the alternative businesses? Can you quantify that? And then, what's the overall penetration of the profitability of the profits of the alternative businesses? Sorry, there's a lot there. I can repeat them.

John David Rainey
Yeah. Rather than talking about all the alternative businesses, I really just talked about membership and advertising, those two as an example. And taking the second part of your question first, the contribution from those to our overall operating income in the quarter, once again, was over 20%. Just marginally over that, I think 21%. So, continue to see similar progress as to what we've seen in prior quarters.

Earlier, I mentioned that ecommerce, core ecommerce was the single biggest profit improvement driver for the quarter. But if I were to combine advertising and membership, put those two together, that actually drove about half of the profit improvement. So again, you see that these higher margin, faster growing parts of our business are having outsized contributions to our profit improvement, while at the same time, in a very healthy way, improving our core economics around the core ecommerce business, which is also driving a big piece of that.

Stephanie Wissink
Mike, just for technical help, when we're looking at is the growth of operating income dollars prior to the investment in our corporate expense. So, think of it as the incremental dollar growth. So, you can sum up and get more than 100%, as you should, and then the offset would be the corporate expense.

Mike Baker
OK. Yeah. OK. That actually makes sense, because I was struggling a little bit with, I know on the first quarter call, you said $900 million, and I was getting something a little bit--when you look in the presentations or the footnotes of the press releases, it's $800 million and change, but I guess that bridges that gap, so thank you for that. But either way, when you do that math, I guess a third of the growth of the first quarter compared to 50% of the growth in the second quarter, as you just said, it actually ends up being pretty close to the same dollar amount. And I guess that consistency in terms of the dollar improvement is telling.

John David Rainey
Yeah. To me, the main takeaway from this is that the table stakes in our business are running a good operation, having the right inventory in the right places, just being good at retail. And we have to get that right for all these other parts of our business to work. We've talked about the flywheel effect, the nature that all these things work together. We're doing a really good job of that. And at the same time, we're seeing these faster growing parts for our business that are higher margin continue to have an outsized influence. So again, speaks to the overall architecture of our margin performance going forward. It just, margins are going to want to go up here.

Mike Baker
Yep, yep, yep. Clearly. Speaking of margins or profits going faster than sales, automation has been helpful there. I think you allude to on the call yesterday, if I think about it, you sort of three supply chains. They probably are all connected more than I think, but three supply chains in the ecommerce fulfillment centers, the ambient ones and the frozen refrigerated ones. I think, correct me if I'm wrong, you're further still on in the ecommerce, but just starting in the frozen and refrigerated where the ambient ones are somewhere in the middle, is one more important than the other, one a bigger driver to profits?

And then a follow up to that, can you discuss your choice of vendors? I think you use three different vendors across all three of those. Is there a reason for that?

John David Rainey
Let me talk about the vendors we use. For our ecommerce FCs, we use KNAPP. For ambient facilities, Symbiotic and WITRON for our perishable DCs. And they're all important. I think it's important to be somewhat diversified here as well. We are able--what we do here, is we complement it with some of our own internal software in some cases. And so there are commonalities between some parts of the platform. To say which one is more important, it's like, which kid is your favorite? They're all really important.

Maybe, if you look by volume, obviously, the perishable DCs with WITRON is something that's going to drive a lot more volume and maybe have a little bit more of an outsized impact. But fundamentally, what we're doing here is providing a different experience for our customers. And our customers don't think about this in terms of perishable ambient or fulfillment centers, so we need to get it all right. It's really important.

Mike Baker
Yep. OK. Makes sense. We have five minutes. I have one more big question, and then a couple rapid fires if we have time. I guess, just how do you think about investing upside? You clearly upside this year. How do you think about investing that in terms of letting it--driving higher sales growth, or more margins, or maybe more incremental CapEx? If you could talk about your capex plans. And/or return to shareholders, increasing the dividends, more buybacks, et cetera, what do you do with all the upside that you're seeing?

John David Rainey
It's a good problem to have, to start with.

Mike Baker
Sure is.

John David Rainey
But I think capital allocation is one of the most important things that any management team should do to make sure that each dollar of capital that they're investing is achieving the highest return that it can. We're very blessed in that we have some very good alternatives, importantly, alternatives to invest in ourselves organically, to drive that kind of growth. It's pretty clear to me what capital allocation will be for the next 18 to 24 months. I've got much better visibility into not only capital spending, but the returns related to that.

As you get a little bit further out and it would stand, I think I'm saying something that, perhaps is obvious to the audience, but free cash flow will begin to inflect a little bit more to the positive, and that's where I think you've got to make some decisions around, is it more share buyback, is it more dividend? Again, very good options to have here, but I think the key thing

that I would want you to take away from this answer is that what we don't want to do is not invest and then find ourselves five, six, seven years from now, needing to catch up.

We want to meter our investment all along, so that we're doing this in a very balanced fashion. So, we're investing in our business, we're returning cash to shareholders, we're having profits fall to the bottom line, so that there isn't a step change at some point in the future to where we have to reset expectations with investors. And so, we are very thoughtful about the way that we approach that. In fact, I would probably go so far to say as in our long-range planning process with our board, this is probably the area of focus this year, is to make sure that we're appropriately investing not only in things like technology, in our platform, but in our associates, in prices for customer, in experiences for customers.

And so, this is one of the big challenges I think every management team has, is how do you continue to invest in for the future, but also realize margin improvements in the short-term? Thus far, I think we've struck that right balance, and we'll continue to try to do so.

Stephanie Wissink
Mike, it's Steph. I would just add, and you are among this group, is starting to recognize that we've gone from a phase of having tension on the line and tradeoffs, to a position where we can do both. We can invest in prices and wage. And through the changing business mix and more pools of profit to fund more things, we can also grow our operating income faster than sales.

Mike Baker
Yeah. That's a great point. Real quick, just one quick follow up there. Did you say free cash flow in flex, did you say that inflects positively after 24 months? I think you said you had visibility in the 18 to 24 months, then I think you said that it likely inflects positively. I just want to make sure I heard that right.

John David Rainey
Yeah, we've talked about that. We think that free cash flow has an opportunity to grow a little bit faster than operating profits over our outlook. And while I'm talking free cash flow, maybe the better way to frame this is operating cash flow. That should drive some outsized performance. And we've also mentioned too that we have a little bit of a bow wave of CapEx, perhaps related to some of the supply chain investments that we're making, and so there is opportunity there, I think a few years out.

Mike Baker
Got it. All right. We probably have one minute. I'm going to bang a couple rapid fire. Inventories, where are they coming down the most, and when do you need to reinvest?

John David Rainey

We feel really good about what we've reinvested in. We're really prepared for the seasonal events. They've come down probably the most year-over-year in fashion. We had too much inventory in that category last year.

Mike Baker
OK. Awesome. And then one more, just remodels. How do you think about, does that need to drive a lift for you guys to do it, or is that just the cost of doing business? And what are you seeing in the remodels?

John David Rainey
Well, it's both. Not remodeling your stores is the road to perdition. We don't want to under invest in our business. And so, there's ongoing remodels or maintenance CapEx, if you want to think of it that way, that's required. But as you know, these newer remodels are a very different one than what we've done in the past, and we've seen improved returns related to them. It's a very different experience in the store. I think, importantly, when we look at the catchment area around the stores where we've remodeled, we also see an uplift in ecommerce, which I think, again, really points to this Omni model, and how that resonates with our customers.

Mike Baker
Yep. Awesome. Appreciate it. 12:45 I'm going to keep you on time. Thank you so much for the time. Thank you everyone for joining us. Really appreciate it and keep doing what you're doing.

John David Rainey
All right. Thank you, Michael. Appreciate everyone listening today. Thank you.

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