Walmart

Walmart's Fiscal Year 2015 Q1 Earnings Results
Media Call Transcript
May 15, 2014

Randy Hargrove: Thank you very much. Good morning everyone. Thanks for joining us for our first quarter earnings call. We're going to have about thirty minutes with you this morning. We will have some brief opening comments from Charles Holley then we'll get to your questions for the rest of the time. Please try to limit your questions to one or two starting out so that we can get to everyone and we will try to cycle through as many times are we can in our thirty minutes. You should all have a copy of our transcript, press release with our financial information. If not, it's available on the investor relations section of our website which is located in our press release. We'd like to keep today's discussion to our finances if we can. If you have any questions afterward, for fact-checking, please reach out to me, to David Tovar, to Brooke Buchanan. We will try and help you out. So with that, I'll turn the call over to Charles.

Charles Holley, Wal-Mart Stores Inc. CFO: Good morning and thanks for your interest in Walmart. I'll start out and say a few brief comments about the overall results of the company and then I'm going to turn it over to our guest today, Bill Simon. Just a reminder, he is the President and CEO of our Walmart U.S. business.

I think you saw the sales that we reported of $114.2 billion dollars; that was up about 0.8 percent. Two things affected that. One, the biggest, was probably the negative impact of foreign currency was $1.6 billion dollars. If you strip that out, you would have had an underlying increase of about 2.1 percent. Also, as a reminder, our international segments, for the most part, all countries except Canada are on a one month lag. So, those countries would have been reported for January, February, March. That would have excluded Easter, so the international segment actually had an Easter flip.

As far as earnings are concerned, we report $1.10 per share. There are two really important things to remember in that $1.02 per share to get to the underlying performance. The first; I think you probably saw that we reported there was about a $0.03 impact for the severe winter that we had in the first quarter. The second was our tax rate. We've guided for the year that we would have a tax rate between 32 percent and 34 percent. This tax rate was around 34 percent, it was at the high end. We expected our tax rate, for the first two quarters at least and maybe three, will be at the high end but we fully expect to be in the 32 percent to 34 percent. That probably had an effect of around two cents per share.

When you dig down into the segments; hopefully you saw that Walmart came in where they guided originally, relatively flat – I think down about 0.8 basis points. International, if you took out the currency effect, I think they actually had a fairly good quarter. They were up 3.4 percent in sales, and 5.3 percent in profit in a constant currency basis, again, if you strip out the negative effects of currency. Sam's Club did have a tough quarter, it was probably lower than they anticipated and we do expect some more head winds going forward and as they invest in their new Sam's Plus Cashback Reward program.

Going forward, our earnings estimates for earnings per share are $1.15 to $1.25 and I'd like to call out four or five things that I think are important, that are embedded in that estimate. First, of course, we will continue to have higher health care costs. The second, head winds I just mentioned from the Sam's Club investment in their Cashback Rewards program. There will be continued impact in our U.S. businesses on the SNAP benefits that were reduced back in the third quarter. And then the tax rate, as I've just mentioned. We will continue to invest in our e-commerce businesses. Just as a reminder, last year we invested around $0.11 per share and on top of that this year, for the year, we'll invest an additional $0.02 to $0.04 cents per share. With that, I'll turn it over to Bill.

Bill Simon: Walmart U.S. President and CEO: Thanks Charles. In just a few minutes I'll give some additional color around the numbers that we released this morning. You heard of this mention weather, approximately $0.03. That came in during the peak storm periods, in snow removal, utilities costs, and in expenses related to the disruption of our supply chain. Despite the impact, total sales were up two percent, same store sales were relatively flat year-on-year.

When we look at our food consumables, and over the counter business, we continue to take market shares measured by Neilson, and our plan is to continue to do that. We launched innovation in several categories in the quarter, with our credential services business with the Walmart-to-Walmart wire transfer business. We also rolled out a new line of organic foods under the Wild Oats brand. We launched a video trade-in program; our Savings-Catcher and even introduced an Auto-Insurance Comparison service, so we're really moving into some of the areas of services that customers have told us that they want to and are very pleased with the initial results of those. You can expect us to continue to do that through the balance of the year.

Of course, I need to spend a moment talking about Neighborhood Markets. We're very pleased with that format. We're approaching 400 units now and will be well over 500 by the end of the year, with comps of 5 percent and traffic increases of 4 percent - very, very effective format for us. I also wanted to highlight something that we're proud of. April marked the 46th consecutive month of positive comps in that format, which maybe gives you a little bit more color on why we are so bullish on that and accelerating it. Also every year-group of stores that are in the ground, Neighborhood Markets are positive, so they're performing well across the spectrum.

We feel pretty good about the underlying business. It has been a difficult winter and when we look at our business in those periods, when there was no disruption from storms, we are pretty pleased with the outcome. Just one quick comment on inflation; inflation over-all has been very low. We've seen some inflation over meat and dairy and it has given us the opportunity to hold our prices. When there is a slight increase in inflation, we are able to buy at scale and hold our prices down and show a price gap and we've been doing that in meat and dairy and that's reflective of seventeen basis points we reported of price investment and our ability to move market, and grow market share in those categories when there is a little bit of inflation. So let me turn back over to Charles and we'll get some questions.

Charles Holley: Thanks Bill. Why don't we just go ahead and open it up for questions now.

Courtney Reagan, CNBC: Hi, good morning. Thanks for taking our call again today as normal. I was wondering if you guys could speak a bit to SNAP reduction. I know it was mentioned again as a negative impact and if you see that normalizing at any point. Or if it is something that from here on out, we should be considering when we look at Walmart earning statements. Thanks.

Bill Simon: Hi Courtney, how are you? The SNAP changes went into effect in our fourth quarter of last year and so I think we'll have that headwind until the anniversary in the fall of this year. Just so everybody is aware, our market share in food is higher than our market share of SNAP, so we under-indexed to SNAP in general. It's impacting us, but I think it is impacting the food business more broadly.

Courtney Reagan, CNBC: Okay, great. Thank you very much.

Siddarth Cavale, Reuters News: Hi guys, congratulations on the quarter. I just wanted to ask, we see that you took it a bit on the cautious side. So, I'm just trying to figure out, could you shed some light on the traffic that we're seeing now that we're getting warmer weather and throw some light on how these months are faring. Thank you.

Bill Simon: Yeah, maybe you're getting warmer weather in New York but we're sitting here, it was about 40 degrees here this morning and there was a high of about 54 yesterday so, it's still chilly across parts of the country. We've got the west that's really hot and the east that's warm right now and the middle of the country is cool. It's very interesting the dynamic that's going on.

We have a customer in the middle and down that's still very cautious. They're very resilient but very cautious. They've managed to find ways to adapt the situation as it exists today. We've seen them spend money to take care of their families at important periods: Easter, Mother's Day, you know, the business is good because the customer is spending. And then they figure out how to solve for their budget hole during those interim periods. I think I'm optimistic about the resilience of the customer in the long run. I think in the short run, near term, there are still some issues that need to be, have to be, solved.

Siddarth Cavale: Thank you very much.

Shelly Banjo, Wall Street Journal: Hi, good morning. Just following up on that, you had mentioned the constant breakdown of the last few weeks of the quarter, so why is the guidance still weak in the second quarter, not expecting that weather to hit.

Bill Simon: Hi Shelly. I think it's just the marketplace right now has got a lot of uncertainty in it. I think consumers, again in the middle and down, are trying to figure out what's going to happen as we head toward the political season and the rhetoric keeps up, I think it challenges their confidence particularly. None of the fundamental dynamics have changed. Household incomes are still flat, inflation, although in a couple of categories that I mentioned, have got a little bit of movement in them. So prices are flat, incomes are flat and I think just out of caution, we are forecasting flat comps.

Shelly Banjo: And just as a follow up to that, this will mark now the sixth consecutive quarterly decline, so is this becoming kind of a new normal that you have to deal with, that you are seeing in a five quarter straight traffic and comp sales. So, is this requiring a change of business model, considering that the wider macro-economy isn't going to change?

Bill Simon: I think we've been flat for five quarters, plus or minus a few basis points, I think 30-40 basis points on the worse end and we were 8 basis points this quarter which is a few million on sixty-seven billion. So, I think flat has been hard for us to break through that, I get your point. Changes to the business model I wouldn't say, but changes to the strategy is what we've been talking about. Improvement in the supercenters, particularly in the bottom 10 percent we've been having difficulty in. The top 90 percent, if we could only report those, we'd be recording positive comps. So we're working very hard on the bottom 10 percent.

We've shifted our strategy, and have been reporting that for a while now, towards small stores. What we're seeing is that the supercenters are very effective, and remain very effective, at stock up, which is why the ticket on the supercenters is growing and the average unit retails are growing but traffic is slightly challenged. We've seen that traffic lift and our Neighborhood Markets have same store traffic increases of four percent, so we can serve the customer in a stock-up in a supercenter and a fill-in closer to their home with our small stores/Neighborhood Markets. And that's the change in strategy; I wouldn't call it a change in our business model, and that's why we're aggressively rolling out that format.

Shelly Banjo: And that 10 percent, would that be about 400 stores, the lowest 10 percent, the Supercenters?

Bill Simon: There about, a little bit less.

Shelly Banjo: Okay, thank you.

Barney Jopson, Financial Times: Yeah, hi. Good morning everyone. A couple of questions about the weather. Firstly, how it affected operating expenses. Bill, you mentioned utilities costs and disruption to the supply chain. Could you just expand a little bit more what you were getting at there?

Bill Simon: Utilities are, I think, pretty self-explanatory, just weather related. We know to the dollar how much a degree in temperature costs us in the marketplace and so the colder than planned, it's just a direct linear relationship to cost. What is really interesting and unusual about this quarter was the supply chain interruption. The sequencing of the storms and the duration of the storms as they tracked across the country actually impacted manufacturing which slowed production, which backed up fleet transportation. Not just ours, but trucking in general across the country. We had to spend overtime and third-party trucking once the storms cleared to get back in supply. And it wasn't because our system couldn't run; it was because many times, the people who work in the plants couldn't get to the plant. And then the trucks that were leaving the plants to come to our distribution centers couldn't get the product moved. So for the first time that I can recall, the entire supply chain in the U.S. got backed up for a period and we need to spend money to expedite that, and I think that was the supply-chain piece I was referring to.

Barney Jopson: I see, yeah. So just to be clear, the utilities, you mean electricity costs then?

Bill Simon: Yes.

Barney Jopson: Okay, and one other question just about on-line. Obviously bad weather prevents or deters people from going out to the store, but they can still order online. So did you see any increase in online orders during the bad weather? And thinking ahead, longer term, could you imagine the online business actually cancelling out the effect of bad weather, because people can still shop in the comfort of their own homes?

Bill Simon: I think we had a good quarter in our e-commerce business in the U.S. and around the world. I think we probably saw a little bit of an increase in online shopping during those periods, but honestly, I'm giving you intuition rather than fact. And I could imagine nearly anything. We'll get you the info on that if you'd like it.

Charles Holley: I actually, this is Charles. I actually think it was a little slower believe it or not. I don't think we have enough data, as Bill said, to give any definitive conclusion, on why it would have been a little slower but I think part of it could have been also the delivery trucks couldn't actually get there.

Andria Cheng, Marketwatch: Hey Bill. So I noticed that you mentioned Neighborhood Market but you didn't touch on Market Express and also the company, you guys opened the Walmart-To-Go. Can you talk a little bit about the performance there and also why the decision to, or so kind of have this other concept.

Bill Simon: We're excited about Express. The top line remains really good. We're very pleased with it and we're working through the opening phase of the pilot which will lead to the opening of about 80 to 100 more units this year. We open a second store on May 2nd, in North Carolina, which is our first, what we're calling fully tethered store, so it's connected from a supply chain perspective and serviced in large part by another store: a supercenter down the road. It is connected and tethered from a customer perspective to Walmart.com so you can get anything that you would like in a small store, which we think, in the long run, is going to be a very competitive advantage for us. So you can stop and get gas in a Walmart Express, and get a bicycle. All you have to do is pick up your mobile phone and let us know that that is what you want, and it'll be there for you. And so, we've started that, and the customers have responded to it. That store opened far ahead of our plan. You will see us do that in several more places this year.

Andria Cheng: And is there any way that you can accelerate the store opening, for the smaller concepts?

Bill Simon: We just did. We went from the plan that we reported in October and then doubled it in January. So we're going to build about 300 small stores, 200 Neighborhood Markets and 100 Express. We have the ability to go faster once we've made the call on the Express stores.

Andria Cheng: Okay, thanks.

Cyd King, Arkansas Democrat Gazette: Yes, I was going back to questions about the weather. I know what the weather has been like here in Arkansas, but what was the weather that had the most severe impact on these earnings? And you mentioned before, that 200 stores were closed was that hurtful?

Bill Simon: Yeah, we didn't sell anything when they were closed. I think that if you lay out our sales, week-by-week, which we clearly do, and put them on a graph, and then you overlay what were three major winter storms against that graph – we missed our entire quarter in those three weeks.

Cyd King: Wow, okay.

Bill Simon: That would be severe.

Kim Souza, City Wire: Hi. I was wondering if you might-could give us some color on the online grocery that you're going to be testing in Bentonville?

Bill Simon: Sure.

Kim Souza: I'm quite excited about that!

Bill Simon: We have, are in the process of building a drive-up, order online, pick up grocery depot in Bentonville. It's a format that we're excited about. It's really a module of a format that we're excited about because it can be attached to anything – a supercenter, a bus station, anything. The customer can order online, tell us what they want from a grocery perspective. Give us an hour to ninety minutes and drive on up and we'll put it in the trunk of your car and you can drive away. We should have that up and running later this year. We're going to play with it and see how the customer reacts to it. We're excited about it.

Kim Souza: Now, you have some something similar to this? Asda has something similar to this already in operation in the UK?

Bill Simon: Similar but not the same. Asda's program operates off of some of their current operating stores and they also have pick up locations around the city. This is a free-standing unit. There will be groceries there on site, and they'll be picked right from the building. It won't be a retail store, it'll just be a depot. You just drive up, never get out of your car, and have it loaded.

Kim Souza: Okay, thank you so much.

Bill Simon: Yes, happy to help.

Siddarth Cavale, Reuters News: Just wondering what sort of initiatives are being done to drive membership now that sales wasn't all that was expected. Could you talk a little bit more about what initiatives you are doing to improve membership out there?

Charles Holley: I'm assuming, this is Charles, you're talking about Sam's Club. In June, Sam's will be launching a membership Cashback program for their Plus members. It's something that Sam's has piloted in Texas for little over a year and it's turned out, we think, very successful and it will be a national roll-out in June. It's been very accretive to membership in Texas and we feel it will be very accretive to membership nationally.

Siddarth Cavale: Okay. Is there anything that stand-alone - Can you guys talk about anything else, because in terms of box-stores, that is doing pretty well, so how is Sam's Club going to get on the same level?

Charles Holley: Yeah, I think that first of all, like I just mentioned the Cashback. But second, merchandise is always the most important thing for our member. Making sure that we have the treasure-hunt feel in the middle of the store is very important. Pharmacy and Health and Wellness have done very well, did very well for the quarter. That continues to build and that's always good for member loyalty.

Sid Ardkhavali: Great, fine. Thanks a lot, thank you.

Barney Jopson, Financial Times: Yeah, hello again. You mentioned healthcare costs, and I think you talked about this last quarter, but could you please give us an update on exactly what is driving those costs higher?

Bill Simon: It would be a combination of the two things I think you would expect, Barney. Increased enrollment: Our plans are very good and relative to what's available in the marketplace. More people have chosen our plan, and chose our plan last year. I think given the comparisons to what else is out there, we saw a fairly significant lift in enrollment. And then you combine that with what has been the issue in healthcare - medical cost inflation. So those two factors are what is driving the change.

Barney Jopson: Okay, thanks.

Andria Cheng, Marketwatch: Hey Bill. So, on the e-Commerce front, you are obviously, I don't know if you would consider that a price-spot. What do you think is kind of like the area that you don't think Walmart has, that you want to expand or acquire? I just want to know what would you think needs to be done? You obviously have investors who are very patient, especially with the smaller stores and online. I guess, what would you think could be done faster?

Bill Simon: We're working, I think we had a very good quarter in e-Commerce and our e-Commerce numbers as reported include things that are what we call, at the intersection of digital and physical. So ordered online, picked up in a store, sort of things. That, we believe, is going to be and increasing competitive advantage and opportunity for us. We can provide all of the customers the things they like about digital, with the immediacy of physical. So we're working hard towards that and that grocery pick-up test in Denver, and the warehouse pilot that I talked about here in Arkansas, are both good examples of that. We're also working on building our two-day fulfillment network in the U.S so that any of the items that we have can be two-day ground to anywhere in the U.S. We've been working on that for a couple of years. That'll help us from a profitability stand-point with split shipments, and from an assortment stand-point where we can expand our assortment into the tens of millions of SKUs that are available.

Combine that with the physical footprint that we have, where we can fulfill, you know we already have 165,000 of the fastest moving SKU's in your zip code, in a Supercenter and we are shipping from about 60 Supercenters. If the order comes and it's closer and less expensive for us to route it through there. So that the combination of building out a robust e-Commerce network and the physical footprint that we have that allows us to do things that our competitors can't do in physical retail and in digital retail.

Randy Hargrove: And I think we've got time for about one more question.

Julie Hyman, Bloomberg TV: Hi all. As you probably know there are a number of protests going in internationally today by food workers who are agitating for higher wages here in the U.S. I think they're asking for the $15.00 minimum wage. And I'm just curious where you guys stand on that national debate at this point? If you have started to model in the effects of that in your numbers at all, if it does end up happening on a national scale, just any other comment you can give on that.

Bill Simon: Minimum wage is a debate that needs to be held in the country. I think it's only one consideration. It's a political solution to an economic problem. What we've got to make sure is that there are opportunities for people. And so, it's not about where you start, it's about how much opportunity that you have. And so our workforce - we're focused on that. We're not a minimum wage payer. Less than 1 percent of our workforce in the U.S., we have 1.3 million associates, something – give or take four or five thousand people, six thousand people, make minimum wage, and they only make that for a very short amount of time as they onboard. So we're not a minimum wage payer by and large.

But it's really about where you can go and not so much where you start. We are not opposed to minimum wage increases unless they've been directed at us exclusively like a year or so ago in

Washington. They had and initial proposal that was very targeted. We can't operate in that environment. They came back after that was defeated with a broad-base minimum wage increase and we didn't oppose it. So I think if jurisdictions, whether it be a state, or a city, or federally, want to have a discussion about minimum wage, that's a good thing. But it's not the solution; it's only part of the solution.

Randy Hargrove: Great. Okay, well we appreciate everyone joining us on the call today. If you have any follow up questions, please reach out to us and we'll see you next quarter.

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