Walmart's Fiscal Year 2016 Q1 Earnings Results
Media Call Transcript
May 19, 2015

Randy Hargrove, Director, Corporate Communications: Good morning, everyone. Thanks for joining us for today's call. I hope you've all seen the press release, transcript and presentation that are out. They're on our website. We're going to go through today's call with a few comments on the business from Charles Holley. Charles is going to be joined by David Cheesewright, Walmart International president and CEO, who can provide a few additional comments on our international business.

We're going to have about 30 minutes for today's call. We've got several of you on the line, so after some brief comments from Charles and Dave, we'll spend the bulk of the time getting to your questions. So please limit your questions to one or two starting out and we'll try to get around to everyone as quickly as we can.

If you need to fact check anything afterwards, please give me a call or shoot me an email and I'll try to help you. And with that, I'll turn it over to Charles.

Charles Holley, CFO, Wal-Mart Stores, Inc.: Thanks, Randy. And welcome everybody on the call. We appreciate your interest in our company.

Overall, we felt like the first quarter was a solid result for us. Sales, which were around flat, were $115 billion. That included negative impact to foreign currency of $3.3 billion. On a constant currency basis, our sales would have been up 2.7 percent. Earnings per share [EPS] of $1.03, and that was well within our guidance of $0.95 to $1.10. There were three major impacts on the EPS: the first was anticipated, it's about two cents a share for the initiation of our wage investment that we've announced; the second would have been our stepped-up investment in e-commerce, that's about two cents a share; and then foreign exchange was about a negative impact of three cents per share. We'd anticipated about two cents per share.

Covering very quickly some of the highlights of the segments, Walmart U.S. had over $70 billion in sales. That was a $2.4 billion increase, up 3.5 percent. That included a comp of 1.1 percent. Traffic was up for the second quarter in a row. Positive comps for three quarters in a row now. Another highlight, Neighborhood Markets continued to perform very well, with a comp of 7.9 percent. Sam's Club had a tough quarter, with lower performance in comps than we anticipated. Their revenues were $13.5 billion. That was down 3 percent, but it was down primarily because of the decrease in gas prices. Without the fuel included in the sales, our sales were up 1.2 percent, and that includes a comp of 0.4 percent.

I won't say much about International with Dave here, other than to say they had a very good underlying result. They were affected by currency, but when you pull the currency out you would see they were able to meet, and slightly exceed, their sales and profit goals.

Looking forward, forecasting our EPS of $1.06 to $1.18 for the second quarter. That would include similar headwinds that we experienced in the first quarter. The first would be the additional investment in wages that we announced, that's about four cents per share. Then the e-commerce additional investment is another two cents, similar to the first quarter. And then the third thing would be the currency, and we expect right now, if everything remains the same, currency impact would be about four cents per share.

As far as the currency for the full year, we've updated our guidance on the impact of what we think currency could do, if it stays the same. Originally we said for the year it would be about $10 billion on our sales line. We've updated that and we think it could be a $14 billion negative impact on our sales line, if currency rates remain the same. As far as EPS related to currency, we had said originally it could have a negative impact on earnings of 10 cents per share. With today's rates, we feel like it could be closer to 13 cents per share.

With that, I'll turn it over to Dave.

David Cheesewright, President and CEO, Walmart International: Thanks very much, Charles. Good morning everybody. I'll just give a quick overview of International, talk about some of our priorities and give you some of the key takeaways for quarter one.

For those of you that don't know International well, I guess we'd sum ourselves up as being big and diverse. Last year's sales were around $140 billion. As a standalone, that would make us the second largest retailer in the world. We operate out of 26 different countries with over 70 different banners. Just over 6,000 stores; 800,000 associates; and we serve 100 million customers a week.

In terms of our priorities, we've been very consistent over the last year and will remain so this year. Number one is to actively manage our existing portfolio. That involves us moving our investment into countries where we see higher growth, but also tidying up the portfolio to make sure we're focused on areas that are core to our business. And you'll see a regular cadence of tidying up the portfolio – examples recently would be the restructure in Japan and the sale of the bank in Mexico – and I'd expect that to continue. Second priority is to actively drive core sales across all our markets, particularly by price leadership and EDLP, and focusing very hard on our fresh business, which is such an important traffic driver for us. Thirdly, to accelerate our e-commerce business, and you'll see us particularly lean into grocery home shopping, and our pure-play businesses in all the markets in which we operate.

Next, to ensure we deliver our market priorities. And we're focused on three last year and this year. Firstly, to deliver a platform for sustainable growth in China, a key market for us going forward. Secondly, to turn around Brazil. And then thirdly, to re-energize our business in Mexico.

And then finally, to strengthen our three key enablers, which is to ensure that wherever we operate, we have the lowest cost-base – that allows us to ensure we can deliver EDLP and save our customers money. Secondly, to ensure that we have good talent in all our countries. And then finally to build trust through our investment in local communities and making sure we do business the right way everywhere we operate.

In terms of Q1, I would say, in line with Charles, that we had a solid first quarter. Both sales and profit were in line with our expectations. Net sales grew 3.4 percent – there was some favorability from the timing of Chinese New Year and Easter. And we saw comp sales improve in four of our five markets. And over the last year, we've seen a gradual improvement in our comp sales across the business, which is very encouraging for us.

Operating income grew slower than sales, marginally, at -0.1 percent. That was where we expected to be through the first quarter, and that's largely the result of some planned investments in accelerating our e-commerce business, but also some pretty tough economic and competitive pressure in certain markets.

In terms of our five key markets: certainly the highlight would have been our Mexican business, with a very strong performance across all formats. We're particularly pleased to see the improvements in our Sam's Club business there. We've seen a significant improvement over the last 12 months in terms of some of their leading indicators – service and membership – and it's good to see that coming through in both sales and profit. Our Canada business was strong. We saw good sales and comp growth, and very strong growth in our e-commerce business there – in excess of 40 percent. China, we saw a positive comp in Q1. Some favorability with the timing of Chinese New Year, but that's a good positive trend for our Chinese business. In Brazil, another strong performance from the e-commerce side. And finally, our most challenging market at the moment would be the U.K. We see continued food deflation, in particular fresh and grocery, and very aggressive competition. Consumer prices, for the full year in April, were down for the first time in over 55 years. But we believe our team have a clear plan and we'll remain focused on executing that.

So overall, I think, very clear on our priorities. They'll remain consistent in the year ahead, and a solid start to the year.

Charles?

Charles Holley: Alright. Thanks, Dave. We'll turn it over for questions now.

Anne D'Innocenzio, Associated Press: Hi. Thank you for having this call. Charles, can you kind of just break down the quarter in terms of, I know, 1.1 percent increase for same store sales, but what were the factors driving that? And are you surprised that the gas price wasn't as much of a lift as maybe you might have expected?

Charles Holley: Sure. I'll take the first part of that. If you look at all categories except for entertainment, which would be like TVs and media, all those categories were up in comps. So we feel very good about what's going on in those categories. When you look at entertainment media, that shrunk a little bit, I think, overall as a market. And there's obviously some of it going online. There's not a lot of new technology. Last year we were comping Frozen; we don't have anything like that this year. As far as our food, fresh categories – although they were up slightly, they did get hit from some deflation that we did not anticipate. I can't tell you what it's going to be going forward, but I can just tell you where we are right now. There has been some deflation, and that would have affected the comp. I think that we said that in our press release. It was about 20 basis points on the total comp. What was the other part of the question?

Anne D'Innocenzio: The other question was where is the consumer now, and are you surprised that lower gas prices weren't as big of a leverage. I think you said in the release that people spent that extra money on saving or paying down debt, things like that?

Charles Holley: Right. You know, nothing surprises us with the consumer. Because at the end of the day, they're going to make a vote on how they feel about the economy and how your merchandise and pricing and assortment is. We did see, it was very similar actually in the fourth quarter, where we did see – and I think you've seen – surveys that said customers were paying down debt, they were saving, but they're also spending. Especially in our fresh categories, we had, although our comps weren't as high as we would have liked in fresh, our traffic was very strong in our fresh categories.

Anne D'Innocenzio: Ok. And if you could just answer the question about the consumer: where is she now? I mean, just – she's using her refunds to pay down debt and if you could just say something about the cautiousness?

Charles Holley: Yes. I think that the numbers you're seeing in overall retail, that you've seen, would tell you that the customer is still somewhat cautious. Maybe a little optimistically cautious, but still a little bit cautious.

Sarah Halzack, The Washington Post: Good morning, all. Just a quick question about West Coast ports – I know some retailers had mentioned that that was a bit of a drag in the first quarter. Just wondering if you could talk about whether that had any impact for you.

Charles Holley: Probably had a little bit of impact on both Sam's and Walmart with the entertainment, the TVs particularly. There was a little drag on sales and getting the product in. By the end of the quarter, most of that disruption on those businesses, though, is over.

Lindsay Whipp, Financial Times: Good morning. I just wanted to ask a quick question about the U.K. sales. You mentioned the food deflation and aggressive competition – what are you doing to counter that competition and food deflation going forward?

David Cheesewright: Yeah. Hi, Lindsay. I'm just actually back from the U.K. last week. I think Andy and the team talked 18 months ago about putting a plan in place to ensure we remain competitive on pricing, which involved reducing our cost-base by over $1 billion over the next three to five years. And that's primarily their focus, continuing to work on some long-term initiatives to make sure that we remain competitive. They're also looking to innovate the business for customers, and if you've seen the new stores at Coventry and Grantham, you'll see a number of initiatives – particularly around the way we present our fresh business and some product innovations across the deli counters – which customers seem to be liking. So a combination of continuing to focus on price, staying the course through a very turbulent environment and innovating our offer for customers.

Lindsay Whipp: So do you think you'll reduce prices further?

David Cheesewright: Our role is to remain competitive on pricing. We measure virtually our whole basket every week so we can see where our gaps with competitors are week-by-week, and we'll take actions week-by-week depending on where competition is to make sure that we continue to save our customers money.

Lindsay Whipp: Can I just ask another question on the new rollout of the delivery service?

David Cheesewright: Sure. You're talking in the U.S. or the U.K.?

Lindsay Whipp: Sorry, in the U.S., yes. I just wondered if you could talk to me a bit more about how you plan to compete with Amazon Prime, given that quite a lot of your customers probably already use Amazon Prime?

Charles Holley: Yes. As we put out, we're doing a closed beta test. We're going to be $50 within three days or less, as far as receiving the goods. There are going to be over one million SKUs available for that – it will not include our Marketplace vendors at the moment. But that's pretty much what we've put out so far.

Luc Olinga, AFP: Good morning. Can you give us your feeling about the consumer in international markets? Because we do not have a big picture here. Your net sales are up, but your operating income in Walmart International is down. So what do you take from this about the international consumer?

David Cheesewright: Ok. On the earnings, I'll just say the shake between sales and profit was pretty much the way we planned the year. We had a number of investments in accelerating our e-commerce business, so that's in line with our expectations and we're still on plan for where we think we'll end up for the full year.

In terms of the consumer and international markets, you know what, it varies around the world. I think, as a generalization, we're seeing consumers still pretty cautious. We see some tough economic conditions, and managing budgets is on people's minds all the around the world. We can see that in products they buy from country to country. But the individual conditions are quite different in different countries. So, for example, in Brazil we're seeing significant increases in utility costs – that's not something that's affecting a lot of other markets.

So it varies market by market; as a generalization, still very cautious and very concerned about making budgets balance. So I think, quite a good time for our businesses overall.

Luc Olinga: Can I just follow up with China? How do you see your performance going ahead in China? You said the first quarter benefited from [Chinese New Year], but what do you expect going forward now?

David Cheesewright: We've been very clear for the last year and a half that our challenge for China is to build a platform for sustainable growth. We see lots of potential in the long term and we're prepared to take our time to make sure we have solid foundations to grow in a controlled and profitable way.

But in the last year, a couple of big milestones for us. We built out a national distribution network – both freezer/cooler and our ambient products. That's a big deal in terms of making sure we can not only manage costs, but also that we get the best quality products direct to our customers. You've also seen us consolidate a lot of our buying offices to make sure that we are consistently delivering to customers and getting them the best prices.

So a lot of foundational work, and I think you're starting to see that now come through in the business performance. It's the first quarter that we've seen a positive comp, albeit helped with some following winds for quite some time. When we look at the competitive data that we can get through Nielsen, we've been outperforming the hypermarket sector for quite some time now, and Q1 was also a milestone in that it also saw us outperform the wider retail sector. So it's steady progress. We're happy to take our time. We want to build our foundations, and we're in China for the long-term.

Olivia Sterns, Bloomberg TV: Hi. Good morning and thank you very much for taking the call. I'm curious as well about the new membership program – the $50 a month response to Amazon Prime. Have you said anything or changed anything about the potential effect on margins and your hopes for sales?

Charles Holley: No. It's really too early, because as I just mentioned, it's a closed beta test and it really hasn't been in full-swing to be able to address that kind of a question. We'll probably have a better idea in about three months.

Olivia Sterns: Alright. E-commerce overall was a little bit disappointing, a little bit lower than forecast. What do you attribute that to?

Charles Holley: Again, I think if you look at the overall retail data in the market, I think retail sales in general were a little softer than maybe the economists would have expected. I will say, we had a 17 percent increase in sales in Global eCommerce – still very healthy, and also outpaced the market.

Jo Ling Kent, Fox Business Network: Hi. Thanks for taking the call. My first question is about currency: you're increasing the hit by about $4 billion. What are you forecasting, what are you preparing for in 2016?

Charles Holley: We aren't economists, so I really can't give you some kind of forecast or estimate for 2016. All I can do is let you know what we see today with currency and the effect on our earnings for this year.

Jo Ling Kent: And my follow-up question is on the e-commerce side. You saw that increase of 17 percent, and you were just talking about the delivery service. When you say you'll know in three months, is that when the beta testing will end and it will roll out to customers?

Charles Holley: No, and I'm sorry that you misread my answer that way. We'll have a better idea of how it's working in three months, but it won't be closed then. We don't have any information right now to share.

Nathan Layne, Reuters: Hello. Good morning. I'm going to try to ask a question about the free delivery service as well. I realize that, like you said, you'll know better in three months, but can you talk in general terms where you see your e-commerce infrastructure or logistics relative to Amazon? And if you were to roll this out in full, what kind of investments that might entail? And whether that is already included in what you flagged in October of last year?

Charles Holley: First of all, I'm hesitant to talk about another competitor because they have a different kind of operation than we do. What I can tell you is we have, in Walmart U.S., 4,500 potential fulfillment centers in our stores. And we feel that's a great advantage that we can leverage. In addition, as you know, we're adding four new fulfillment centers around the U.S. this year that will make it easier and better to get merchandise to our customers and much quicker.

We're also doing a number of tests, and I don't think it's going to be one-size-fits-all on how customers get their product. They may go to a store, they may want to pick it up at a remote point, they may want it delivered. And as you know, we're trying all of these types of delivery methods across the U.S.

David Cheesewright: And the other thing, Charles, is that, you know, obviously one of the nice things about having a portfolio is the fact that we've got centers of excellence around the world. In the U.K., we've got one of the largest grocery home shopping businesses in the world. We've been at it for 15 years. There's a lot of great learning there. So it's great to see some of the associates who've grown up in that business going across to the U.S. business, and we've just set up an international acceleration team based in the U.K. to make sure that we take those sorts of best practices and deploy. I think particularly in the area of grocery, where product knowledge, understanding of the fresh supply chain, operational excellence, is going to be such a key part of being successful in that space. Alongside the stores that we've got – nearly 10,000 across the world – as distribution points, that puts us in a strong position.

Paul La Monica, CNN: Hi. Thanks for taking the call. I was wondering if you could discuss a little bit more the wage increases that went into effect in April, and any thoughts at all on when that may be a positive for the company in terms of maybe higher sales. Especially when you look at Target, TJ Maxx, McDonalds, many other companies raising their minimum wage – is that going to have a spillover effect even though it's hurting profits right now.

Charles Holley: Well, we're already seeing – across the board – better customer-track surveys coming out of stores. So we think it's already starting to have a positive effect. Just as a reminder, we went to $9/hour in April and the associates will have an opportunity, a starting wage, of $10/hour starting in February. Also, it wasn't just the starting wages. This also filtered through to the other levels and there were over 500,000 associates who actually saw an increase in their wages. So everything we're seeing from our customer engagement and our associate engagement has been positive so far, and we do think that it will have a positive effect in the long-term.

Paul Lamonica: On sales?

Charles Holley: On sales.

Andria Cheng: Hi. Dave, can you just talk about – for those of us who don't really know – what's the difference between a U.K. customer versus a U.S. customer? What exactly is the challenge that Walmart's going through there in the U.K. market? And what exactly is the team you were talking about the company just set up? And then, Charles, another question for you: with the foreign exchange impact, four billion is a huge number. So what can you guys do? Are you hedging differently? Or can you just talk about what you're doing to mitigate the impact?

David Cheesewright: I'll kick off, Charles. I think for the consumer in the U.K., it's actually not a bad time, because there's some significant deflation in consumer prices and they're getting as good as deals in terms of their weekly food shopping as I've seen in a long period of time. A lot of that's driven by just the dynamics in the market at the moment. In the main supermarket sector, which has traditionally accounted for the vast majority of the market, you've had a lot of structural changes in the last two years: three new CEOs, a significant number of profit warnings and a lot of relatively unusual behavior in terms of the appetite to sacrifice profit in order to chase after sales.

You know, we're going to be in the business for the long term. We take a long-term view and I'm very pleased that the team there identified a year and a half ago that this was something that was coming. We've set a very clear plan to make sure that we remain a steady business throughout that and keep serving customers. And from what I saw last week with the team, they're very focused on getting on and delivering that. So it's just a very different market in terms of competitive view, not necessarily from a customer perspective.

Charles Holley: And I would think globally, Dave, that whether it's in the U.K., the U.S. or China, our customers will continue to aggressively seek value.

David Cheesewright: Yeah, I think so. Yeah. As I say, economies are tough everywhere. People are worried about balancing budget. And that's a time that we thrive. So, I think, good times for us.

Andria Cheng: Ok. Can you talk about that team that you're setting up?

David Cheesewright: Yeah. So, it's an international acceleration team. And one of the things, as I say, we're very fortunate to have is quite a diverse portfolio of businesses across international. We've got around 15 different formats in 70 different banners which we've, in some cases, acquired and, in some cases, built ourselves. And what that means is that generally we have a lot of innovation across our business.

Now, as I said before, in e-commerce and particularly on grocery home shopping, the U.K. was very early into that side of the business. Asda is one of the leaders in that and has 12 – 15 years of learning around how to do that business well, both from operational and in terms of what customers want to buy. So rather than have every country re-invent that themselves, the acceleration team's job is to take all the best practices that Asda's learnt over the years and provide a centers of excellence where all our other countries can go and learn all the mistakes and priorities from the last 15 years and implement them straightaway for customers. So I think that'll allow us to move much faster and much more accurately in the countries in which we operate. It also applies to the U.S., where we've got a number of leaders who've grown up in the U.K. grocery home shopping business working for Neil Ashe [President and CEO, Walmart Global eCommerce] out in San Bruno.

Randy Hargrove: Ok, I think this will be our final question. We have time for one more.

Anne D'Innocenzio: Hi. This is a question for Dave. Last week Walmart launched the Alipay in China. Can you just talk a little about the Chinese consumer and online and what are some of the other services you're offering and just how differently they shop there? You know, obviously it's exploding there.

David Cheesewright: Ok. You know, I think the biggest difference in China is just the breadth of the market – in terms of everything from affluence levels, to the way people shop on foot versus car; it's just a very different market. Growing very quickly and people migrating up the affluence scale very quickly. So we have to have a broader offer than we have in most other areas.

We focus very much on three main formats, so we run what you know as a Walmart supercenter – across the business they tend to be big destination stores – a lot of traffic by foot, but that's where people will buy their general merchandise needs. We have a small but very good Sam's Club business, which tends to cater for a more affluent customer – and some of our largest grossing clubs in the world are actually in our China business. And then we have an e-commerce business. We're a majority owner in a business called Yihaodian. It's based out of Shanghai. And that focuses on grocery and consumer electronics, and is very, very efficient at taking orders and getting those direct to customers' homes. I think the opportunity for us in the longer-term is how we integrate these services for our customers. And we're trialing a number of options at the moment, including looking at picking groceries from stores and getting it to customers, and integrating the Yihaodian and store platforms.

So you know, customers still very, very focused on value. And I think one of the other things that I'd point out that's unique about the China market, is it's very, very focused on authenticity. Brands are very important – to make sure that the product they buy is what's advertised on the outside. And I think our ability with a global supply chain – and particularly, as I mentioned earlier, having built our own centralized distribution network – allows us to get a good quality product that's reliable and trustworthy to customers in a very efficient way.

Randy Hargrove: Thanks, everyone, for joining us for our first quarter. We'll be back with you in August for our second quarter results. Thanks very much.