FINAL TRANSCRIPT

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PRESENTATION

Greg Melich - *Morgan Stanley - Analyst*

Well, good morning, everyone. I want to thank everyone for getting here to the Crowne Plaza and finding the other entrance this morning for what becomes a bigger annual event year, the Morgan Stanley Global Consumer and Retail Conference. I get the pleasure today. I am Greg Melich. I head up our retail research team at Morgan Stanley, so I get the pleasure today of sort of kicking off the conference with kicking off the largest retail and consumer company in the world, and frankly at this point, maybe the largest company in the world as we check market caps. I didn't have a chance to update it all yesterday.

And with us from Wal-Mart, it is a great pleasure to have Eduardo Castro-Wright, who is the President and CEO of Wal-Mart US. Eduardo has been in that position for three years. He just executed on his first three-year plan for -- a much greater focus on capital allocation was driven through the organization, inventory management, and now increasingly, merchandising and other key areas. So I think today he will give us a little bit more idea of his next three-year plan and how to keep Wal-Mart in the US as a growth business.

So, Eduardo, I want to thank you very much for coming. And with that, I will hand it off to you.

Eduardo Castro-Wright - *Wal-Mart Stores, Inc. - CEO, Wal-Mart US*

Good morning. Thank you for joining us this morning at this early hour. Someone was teasing me from my team here that in Bentonville we get up much later, so for me it is much more difficult to be here at this time.

By this time -- by the way, I have some of my colleagues from the Wal-Mart in New York office with us today. They are driving our apparel business. And based on what we share with all of you, they are doing a great job. So welcome to you, too.

Let me start first by making sure that the lawyers don't -- or that I don't get in trouble with the lawyers. So I will be making forward-looking statement. And as such, I please ask that you go to our site and read the statement that appears right now up there on the screen. I will not read it for you right now, but you are all forewarned.

Let me briefly start with the performance of third quarter from corporate, Wal-Mart Corporation, entire Corporation. We reported earnings, now it's about a week ago, or slightly over that. As reported at that time, net sales grew by 7.5%. If you look at that number, you basically break it out, and Wal-Mart US having grown the business at slightly below that number, Sam's Club at around the average, around that number, and then international driving double-digit growth rates in sales.

Operating income grew at a slower pace than sales, which is obviously not our objective. Let me briefly explain that, and I will show you later on during the presentation, as I cover the US business, I will share with you why this is the case. But you could basically summarize it in three main factors.

The first one -- the fact that we had a significant impact from Hurricanes Gustav and Ike. Both of those had us close over 300 stores at one point in time. The impact of those hurricanes, because we are self-insured for named storms, resulted in expenses that obviously we didn't have last year and certainly we didn't plan for.

The second big factor is one that I am very proud of, even though it does cost us at the expense line, and that is simply that because of our performance, we increased our accruals for incentive bonuses for our field associates. So as I've shared with all of you in the past, we created a, what we call it, MyShare incentive plan with associates in every store, whereby they share in the results of the Company.

And basically, the way that the formula works out, every store has a plan. The plan, if you are above that plan for the store in three dimensions, that is sales growth, profit growth and customer experience scores -- and inventory, I'm sorry, so it is four metrics. And each one of those weighs 25%. And if you are ahead of the plan in all four of those, then each one of the associates, everyone from the entry-level positions to the store manager -- not store manager, I'm sorry, up to -- hourly associates only, will share in the performance of the store every quarter. So we pay those bonuses quarterly. And that had an impact on performance overall.

The third component of this increase in expenses is something that we've shared also with you in the past, and it has to do with what we call transformation. And as you will see later on, a lot of it relates to merchandising systems. So these are investment both in software that will be capitalized, but also in all kind of expenditures related to consultants and support to develop these new systems that will enable us particularly in merchandising.

So again, this is an expense that is nonrecurring and that will have a beneficial impact once all of those systems are fully in place. And I will give you a sense of where we are today with those systems and what are the expectations in terms of the functionality that they will provide us, particularly, again, in the area of merchandising.

EPS growth, you saw that. You have to remember also that in the prior quarter, and I just noticed that it doesn't say here which quarter it is. Somehow it got erased. In the prior year's quarter we had about a $0.01 benefit there. And so you can make your own calculation, but we grew EPS by double digit.

What we're really proud of is the way that we have managed free cash flow. The fact is that we have instituted a very disciplined approach to inventory management. And as a result, in spite of the fact that we had, in this quarter we had a distortion because of the adjusted dates that we pay the suppliers. We had a distortion with payables that impacted cash from operations.

The fact is that, thanks to a very well-managed inventory process that saw inventory grow 2.2% on sales growth of, for the year to date, of over 9%, so you look at the numbers for customer operations is something we feel very good about it.

As you all know, we slowed down some of our growth here in the US. I will cover that at length, because I think that somehow the notion that we are slowing down is related to the lack of opportunities in the US market is completely wrong. I want to make sure that everybody understands -- that I've read in several reports from analysts around this room and elsewhere about the fact that we are favoring international growth because we can't find growth here. And I've just got to show you some data that would indicate the contrary. As a matter of fact, we feel very good about our growth prospects here in the US, as demonstrated by our ability to grow in this very difficult environment.

So, that is cash flow. Again, I feel very good about it. And it will continue to perform well simply because both the capital efficiency model that we've put in place that has us investing in new store and facilities around the world in a very much more disciplined approach and a approach that ensures the return on invested capital that meets our hurdles every time, and the fact that we've got an inventory management process that it's new, that it's supported by new technology in stores is one that -- both of those just bode very well for cash flows in the future.

Let me briefly cover the US with a little bit more detail than we did at the earnings call. If you look at sales, sales grew 6.1% there. Comp growth for the quarter was 2.7%. That 2.7%, as I will show later, is slightly lower than what -- the growth rate in the previous quarter. The growth rate in the previous quarter, however, had beneficial impact of the famous checks -- yes, stimulus checks. I'm sorry. I always forgot that word, conveniently so, I think, but the stimulus checks.

We saw, however, our operating income grow faster than sales, which is one of the stated objectives that we have in the business. Now, that number there is actually deceiving in the sense that operating income adjusted for what I just mentioned before. So the impact of the hurricanes and bonuses, the increasing bonuses for associates that -- by the way, those accruals are mostly in the US business. As a matter of fact, those are exclusively, I would say, in the US business.

Those expense components, actually, if you factor those in these calculations, what you will find is that we grew operating income at double-digit rates. So very strong growth, almost grew operating income at twice the rate of sales.

And that, combined with the inventory management process that I just talked about before, resulted in returns on investment now growing 21 basis points for the US business. And I remind everyone that the US business has suffered for many years now with a declining return on investment. That trend has now been reversed. And starting with this year, we are seeing our return on invested capital grow back, and we see this as a sustainable opportunity for us.

So, comps, I discussed that briefly already. If you look at comps increasing, basically, essentially, the comps in first, second and third quarter this year are about at the same level once you factor in some noise in the second quarter.

So, solid growth, a debt level that will enable us, demonstrated by the third-quarter operating income growth, we're able to leverage sales growth and deliver profits ahead of the growth of sales.

This is an interesting one, and I thought that I would put this up because, obviously, this chart speaks volumes about where we stand today competitively. The previous one, obviously, should give you a sense of where we are in absolute terms. We feel very good about our current performance.

But this one tells a story that would indicate that the gap between Wal-Mart and the rest of the market is widening quite substantially. If you look at that last column, that is the share of the total United States retail growth in that quarter. That is over 30%. Now, if you were to look at that number for the month of October exclusively, it was 51.7%. So more than $0.50 of each $1 of growth was captured by Wal-Mart US.

That is not just happening because they like us, necessarily, but it is happening because they trust us. They trust our brand. And they trust our brand because we have made significant investments in presenting the brand in a way -- the customers not only trust us to deliver great prices, but also trust us to deliver great experience in the stores.

Our Fast/Friendly/Clean metrics that we started measuring through a very robust survey that we have every month, we conduct every month with customers across the US, I've shared this in the past, it is over 100 million surveys per month. So every store actually gets a significant number of customers to respond about their experience. And therefore, the data that we capture is valid store by store, and it is actionable, because precisely customers are telling us how did they feel about their individual store.

Because of that, we have been able to put in place a very robust process to actually address issues. And as a result, we've seen our fast, friendly and clean scores increase significantly throughout this past year. Very proud of the work that Bill Simon and his team are doing here.

The fact is that I believe that customers, in many ways, are coming to Wal-Mart today not only because they know that they can find the best values in the marketplace, but also because they enjoy their experience. And this continues to be a work in progress. We're not completely satisfied with all the results. But we feel very good, again, about how this has helped the financial performance of the unit.

Let me talk a little bit about the consumer. And what I will try to do is, I'm not going to give you a lot of information here because I think that we shared a lot of information already with all of you during our analyst conference about three weeks ago. So in three weeks, not a lot changes, right, so why share?

Well, actually, in three weeks, it does change. And so, I will share with you what has changed. And there are some nuggets there that I think are interesting. Gas prices -- I've gotten a lot of questions from people who say, so, gasoline prices have come down. Has that impacted consumer behavior in any way?

Surprisingly, yes. Actually, it has. It is almost immediate. And it is very interesting, because I shared with this group, or a group of analysts, rather, during our conference, the fact that we had seen a consumer behavior change when gas prices started to go up. And the way that consumer behavior changed, basically what we saw is that wherever and whenever the customer had to travel a long distance, like in the case of our rural stores, then the frequency of the trips was being cut down. So consumers were reacting to that expenditure.

I shared at the time that when you looked at suburban stores, that traffic had just also been -- frequency also had decreased and ticket had increased. So again, a clear indication that consumer behavior had changed, that customers were buying less frequently and stocking up when they shopped at Wal-Mart.

Well, if you look at what happened in the last month in October, and I have a year-to-date number through September, so you could, probably, you could say that September must have been a little bit higher because it was a growing distortion in the market.

And then prices dropped. Prices in September were on average about 30% year to date higher than prior year, while in October gasoline prices dropped, and they were on average about 8% higher than the prior year, same month the prior year. And sure enough, if you look at that light-blue column there, that is rural customers. Traffic to rural stores increased in October, when traffic had been decreasing in previous months, simply put, because they were changing their frequency.

If you look at even urban customers, you see that traffic again increased in October relative to the average for the prior months, a clear indication that customers now are shopping more frequently because gasoline prices now are a lot more affordable than they were before.

One thing that the chart doesn't show, but I can share with you, is that we have not seen significant changes in ticket. So we expect that this change in behavior will favor us.

The second thing that I wanted to share with you, because also everybody is asking whether we will have a Christmas, and I think that Lee said it well. He said, Christmas will come. And we believe it will. And yet how it will come maybe is more of the question.

This again is the difference in comps if you take everything that is nondiscretionary and everything that is discretionary -- in nondiscretionary, we have put in basically everything that has to do with the grocery business, so food and consumables are in that nondiscretionary category. And what it shows is that the spread in comps between nondiscretionary and discretionary grew from about 500 basis points through the second quarter, in the third quarter grew to over 800 basis points, and in October it grew even beyond that to 800 and almost 900 basis points.

Clearly, the consumer does not have the ability to spend as much as they did at the beginning of the year. Their decisions in terms of discretionary spending are being guided by their disposable income. And with disposable incomes dropping, the expectation that you will see such a behavior, it's there. I just wanted to confirm it with data that we have from our own sales.

So what are we doing about that? Because you would say, well, then, how is Wal-Mart going to perform? And I don't know about the rest of the retail industry, but I have read and heard that most of the industry is struggling. But we actually have found ways to sell a lot of discretionary merchandise.

You think about, so will Christmas come? I thought that the best way to kind of give you a little confidence in terms that we believe that it will is by showing what happened at Halloween. If you think about Halloween, it was the same situation -- will the consumer spend in Halloween? Will they buy something that is, again, discretionary?

And yet, when you have the right prices, when you have the right offering, when it is presented with authority, what we saw is clearly that the customer responded. And we actually had double-digit growth rates in Halloween merchandise, which probably you would not have expected, but that is part of the reason that we are having the kind of results that we have.

Comps, comp sales for Halloween merchandise was a very strong 7%, or 6.9%, which again was ahead of the comp for the rest of the store. As reported by us, our comp growth for October was 2.2% for the Wal-Mart US business. And yet, the Halloween growth for the season was a very strong 6.9%, clearly an indication that when you have the merchandise, when you present it with authority, when you have great prices, customers respond. And that is what you will see as we enter the holiday season, the Thanksgiving and then -- blitz and then leading to Christmas.

Price leadership, you will see a lot of price points across the store, with more and more a move to single price points, single dollar price points, with an authority that makes it simple for the customer to shop. Choices, therefore, are easier for her to make. And therefore, we are achieving both a faster shopping experience and one that is also -- that customers like better.

So price leadership, you will see a lot of price leadership, a lot of rollbacks as you go into our meals solutions for the customer during this time of the year. The graphic or the picture shows there, actually, under meals, it's our latest tab for Thanksgiving dinners. And what you will see there, it's an incredible effort by our merchants to drive prices of food down so that American families can enjoy their Thanksgiving dinner.

And that, coupled with, again, a very deliberate and well-presented merchandise assortments in gifting and candy and what we're calling our Christmas Shop, so the core at great prices. If you go to our stores, at least the larger stores, you will find that as we open the -- the customer walks through the general merchandise side of the building, they should find a seasonal presentation that is incredibly well priced, but also that is very easy to shop, with an offering that has benefited from John Fleming's work on Win/Play/Show and the fact that seasonal has been one of the categories that we have defined as a Win category, because of just the newness that it creates in the stores.

So if you look at our stores going forward, and you've heard a lot about Project Impact, what you will see is that we are anchoring the store on two pillars. One is fresh, the fresh offering that drives traffic, and the other one is a seasonal offering that anchors, then, newness. And between those two, we believe that we have a very powerful presentation for consumers in Wal-Mart Stores.

I have some commercials I was going to show, but I think I'm running a little late. So I just won't do that.

Let me move beyond this holiday season, because of course your analysis of our business does not end this December. I know that all of you are looking at two and three and four and five years out. So let me share with you what we are doing medium and longer term with this business and why I believe that we are very well positioned not only to continue to gain market share, as I've just shown you, during these difficult economic times, but more importantly we are very well positioned to gain share in the future once the economy turns and consumers have more disposable income.

You have seen this. This is our framework. It is how we define our business, both inside the Company, so it has become a communication tool that cuts across all parts of the Company, and also including, obviously, stores -- very importantly, stores. But also, it is the way that we are communicating with the external world, particularly suppliers.

So it is simple, but it is I think very powerful. We define what we stand for, who we are as we save people money so they can live better. Save money, live better -- it is the way that we define how we deliver value to customers. So if you are a supplier of Wal-Mart, that is where the discussion always starts -- conversation, I should say, not discussions.

And that is simply, we establish that if the customer expectation from us, from our Wal-Mart brand, is that we will save them money, then if we can't have price separation, then delivering on that expectation by customers becomes short of impossible. So we work with suppliers. And they understand that value proposition, that in order for our customers to save money, we need to save costs, or else it is difficult to deliver on that value proposition. That is a very important component of the way that we go to market, because at the end of the day, the trust that customers have in the Wal-Mart brand is one that we can't break. And our suppliers understand that.

If you move to the right side of that wheel, you have Win/Play/Show. At a past analyst conference, we explained thoroughly what that means. But Win/Play/Show is how we go to market. That's how we define the assortments. That is how the merchandise organization makes decisions in terms of what categories we will expand and grow, and what categories we will only show or play in.

And it is a major change, because I've shared with this group in the past that many times in merchandising before, we had [14 separate] CEOs, so everybody was CEO, and trying to get an offering for the customer that made sense was very difficult. What this has done is it has brought a level discipline and engagement to the merchandising organization that I don't believe we had in the past.

I think it is a cornerstone of the success that we're having right now. Customers now, and we as a brand, can offer our customers assortments that we feel that meet that Win/Play/Show strategy based on the criteria that we have defined for each one of the categories within the store.

And Fast/Friendly/Clean, that is how our customers should experience the Wal-Mart brand. Again, I think that's been a major change in the way that they experience the brand, is precisely faster checkouts, friendlier associates and a clean store.

The clean store has more to do with uncluttered stores than anything else. If you look at, those of you that visited with us in Bentonville and saw our remodeled store, and Store 1 had a sense of what that looks like. We opened several stores last week that were ground-ups that already incorporate all these principles. As a matter of fact, we will be in Dallas shortly to show some of our Board members that.

So let me just go to what Project Impact looks like, and I won't go into any specific detail here. I will be happy to take questions later on on this. But if you look at what are the initiatives, the individual projects that fall under "save money, live better," so there's a very disciplined approach to how do we deliver on this promise and how will we go to market in the future with Win/Play/Show, and how do customers, how do we ensure the customers experience the brands in stores.

Things that are relevant, we think, here, in addition to price leadership, and obviously everything we do is about price, but the consumables initiatives -- it is very important. You have to remember that with our frequency and the stock-up nature of the trip that customers make to our stores, the ability to capture sales in departments other than the traditional consumables departments -- so your paper goods and cleaning goods, and if you go to everything, for example, that has to do with socks and underwear in apparel or has to do with weather stripping in hardlines or motor oil in automotive -- anything that has a consumption patterns that has high velocity, we would define that as a major area of opportunity for us.

And the work done in this last year in consumables is remarkable. Weather stripping is something that is not that exciting, I think, at least the last time I saw. And yet, if you look at our weather stripping category, actually, it was incredibly exciting because comps are 80%. Now, that's, for a category that it's, quote/unquote, not exciting, it's something that really speaks volumes about the ability to drive growth with our consumables.

The other major component of -- an important piece of this is our space optimization initiatives. Space optimization that will drive returns in the future is mostly linked to the fact that we've got great systems in place that will help drive sales and profit in the future.

Some of the things that we're doing in price leadership, the main thing there that you can take out is the fact that perception scores in price have continued to grow. And that is obviously something that we're very proud of.

If you look at this, for example, I've also read in many places about the quarterly comps by other grocery stores and the fact that some of our grocery competitors actually are seen as growing faster than us. I just want to set the record straight. We are growing faster than any of the four largest grocery chains in the United States.

If you look at the comps difference between where they were a year ago and where they are today, that number that you read there, the 230 and 223 and 491 and 439 basis points, that is the difference in growth between Wal-Mart and each one of the different largest grocery competitors in grocery business. And the grocery business for us is defined as our grocery offering of food and consumables and pharmacy.

You have seen this. I'm not going to go into it. Win/Play/Show, like I said before, is how we go to market and how we make merchandising decisions. John has defined a way to organize the merchandising effort under the merchandising transformation banner. And it is something that is a work in progress. But we feel strongly that with this type of organization and the Win/Play/Show definition of how we go to market, we will actually see benefits in years to come.

Let's talk about systems, what kind of investments we are making in systems. And this is what you will see when it comes to pricing tools, planning tools, space optimization tools. Like I said before, that is probably where I see the most potential for return on investment expansion. We are building smaller stores, but much more productive stores.

Some of the things that I got asked last time, you saw that we are changing the way we present merchandise before making the decision and starting to build stores as we are today, or remodeling the stores that we are today. We actually studied quite a bit this channel. We have had a group of about 38, 40 stores where we changed the way that we present merchandise, change the way that we feature merchandise. Gone are, from those stores, those features -- product features and actionality. These are some of the results. As you can see, there's been improvement in how customers perceive the store, not surprisingly. It's a nicer environment. But from a financial point of view, we have comp sales growth, and inventories come down also significantly.

This is what Project Impact is doing, actually. It enhances the margin by providing the opportunity to present merchandise that we did not present before or that the customer didn't -- wasn't exposed to before. If you think about the way that we had our stores laid out, some of the merchandise, particularly in apparel and home, actually we were disadvantaged in that the customer had to walk into a pad quite a bit before finding all of the merchandise that we have to offer.

The new design, as you saw, has a central alley that -- what it is doing is now it is having customers consider us in categories that they were not considering us before. Nowhere probably has that been more [truthfully] than in the kids' apparel, for example.

This is what we expect in terms of the conversion of the store base. In three years, we will be at 70%. So by then, we would have reached critical mass. Longer term, what you will see from us -- I didn't how share a lot of this during our last time at the analyst conference. But beyond Project Impact, we obviously are working on what we call high-efficiency retailed formats. These are formats that would deliver much higher sales per square foot, and therefore will drive return on invested capital.

And the premise here is smaller stores that would allow us to penetrate markets where we don't have a presence today, but also that provide the customer with a very efficient way of doing one of the different shopping trips that she typically does. Whether it will be a stock-up or a quick trip or a fill-in trip, or whether it is a mission-critical type of a trip, the way that we have designed the store will allow for that. Beyond that, integrating our online effort, our mobile effort, and the way that we deliver, again, value to customers will be at the center of every effort that we make.

I just don't want to end without clarifying this. So I did this last time. I told you why I didn't believe that the US is not a growth market for us. This is very simple. 15 opportunity markets -- by the way, these are not necessarily the most urban and not necessarily the largest markets. We just call them 15 opportunity markets because these are markets where we have a 3.9% share, as opposed to our average of 8.9%.

Now, you take those top 15 opportunity markets, they represent 34% of total US retail sales. Those markets actually are nearly the size of the entire retail market in China. And nobody here will say that China is not an opportunity. And if you look at -- they are also larger than Russia and India combined.

Now, if you think about this scale and think that we have a very low penetration in those markets, logic will tell you that the growth potential for the Wal-Mart US business is real, is there, and it is waiting to happen.

Moreover, I have heard also some commentary from some analysts relative to we are favoring the growth of international over the US. That is not necessarily accurate. If you add the Wal-Mart US and Sam's Club sales, both of which obviously -- I'm sorry, capital expenditures, both of which obviously happen in the US, and then you compare that to international, we still are investing significantly more in growth in the US than we are in international markets. That is not to say that we're not growing internationally like crazy. But the fact is that it is not accurate to say that we have stopped growing in the US. That is not accurate.

With that, there's an appendix if anyone wants to read it. I know I'm out of time, so I will thank you. Thank you, everyone.

Greg Melich - *Morgan Stanley - Analyst*

In the interest of time, I think we will do all the Q&A in the breakout session with Eduardo, which is right next door here.
