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LOW.N - Q1 2024 Lowe's Companies Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good morning, everyone. Welcome to Lowe's Companies First Quarter 2024 Earnings Conference Call. My name is Rob, and I'll be your operator for today's call. As a reminder, this conference is being recorded. I'll now turn the call over to Kate Pearlman, Vice President of Investor Relations and Treasurer.

Kate Pearlman - *Lowe's Companies, Inc. - VP, IR & Treasurer*

Thank you, and good morning. Here with me today are Marvin Ellison, Chairman and Chief Executive Officer; Bill Boltz, our Executive Vice President, Merchandising; Joe McFarland, our Executive Vice President, Stores; and Brandon Sink, our Executive Vice President and Chief Financial Officer.

I would like to remind you that our notice regarding forward-looking statements is included in our press release this morning, which can be found on Lowe's Investor Relations website. During this call, we will be making comments that are forward-looking, including our expectations for fiscal 2024. Actual results may differ materially from those expressed or implied as a result of various risks, uncertainties and important factors, including those discussed in the risk factors, MD&A and other sections of our annual report on Form 10-K and our other SEC filings. Additionally, we'll be discussing certain non-GAAP financial measures. A reconciliation of these items to U.S. GAAP can be found in the quarterly earnings section of our Investor Relations website.

Now I'll turn the call over to Marvin.

Marvin R. Ellison - *Lowe's Companies, Inc. - President, CEO & Chairman*

Thank you, Kate, and good morning to everyone, and thank you for joining us today. First quarter sales were \$21.4 billion with comparable sales down 4.1% from the same period last year. Despite the continued pressure in DIY bigger ticket discretionary spending across the industry, we

delivered better-than-expected spring seasonal sales. Overall, we performed well in a challenging home improvement environment, as we adjusted our strategy to win the early spring customer and take share in key categories with data-driven marketing campaigns and our compelling seasonal assortment, which includes our industry-leading outdoor power equipment lineup strengthened by the launch of Toro.

We also gained traction with our total home strategy reflected in our positive Q1 growth in Pro and online sales. In addition, we improved customer satisfaction while also maintaining a disciplined focus on our perpetual productivity improvement or PPI initiatives across all functional areas of the business. Overall, we're excited about our spring strategy, and we're pleased with how our SpringFest campaign resonated with customers, especially in smaller ticket lawn and garden projects. The combination of the right brands, compelling offers, strong store execution and more nimble marketing helped us capitalize on this key time of year. Bill and Joe will provide more detail on our spring and PPI efforts later in the call. Now turning to Pro.

As I mentioned earlier, we delivered positive Pro comps in Q1 as our strategic investments to improve the Pro experience are driving increased sales and improved customer engagement. Specifically, investments to improve service levels as well as our expanded brand portfolio that now includes Klein Tools are strengthening our relationships with this core customer. This customer has proven resilient as reflected in the recent Pro survey with healthy backlogs in line with last year. Our strategy continues to focus on taking share with the small- to medium-sized pros such as repair and remodel contractors, property managers and tradespeople.

We estimate these Pros represent half of the \$500 billion Pro market, which remains highly fragmented. We are striving to provide a high level of service with the small- to medium-sized pros as we continue to build trust and credibility. And we continue to invest in Pro growth, which includes expanding our capabilities to handle larger order delivery to the job site while also opening new Lowe's Pro supply branches around the country. There is still significant runway ahead of us to grow our sales with these customers while also leveraging our retail footprint to drive profitability. Now shifting to online.

In the first quarter, online sales were up approximately 1%. Our ongoing improvement in our conversion rates in Q1 offset continued pressure in bigger ticket DIY categories. This quarter, we expanded our same-day delivery options by partnering with DoorDash and Shipt. Lowe's is the first home improvement retail partner on these platforms and their members now have quick and convenient access to wide assortment of home improvement products across the country. These new partnerships complement our existing same-day delivery options with Instacart in addition to our same-day delivery option on Lowes.com using our last mile partner OneRail.

Our objective is simple, giving customers access to the home improvement products they need, however they choose to shop. And we're tailoring our digital experience to support the unique needs of different customer shopping journeys based on the type of project. And we're also using virtual and mixed reality to make it easier for customers to explore and visualize different possibilities for their home. Another exciting step forward for Lowe's this quarter was the national rollout of our DIY loyalty program called MyLowe's Rewards. This program is designed to reward customers for choosing Lowe's for their home improvement needs by earning points toward MyLowe's Money, providing free standard shipping as well as other offers and gifts.

In addition, customers can also save 5% every day on eligible purchases with the MyLowe's Rewards credit card. As MyLowe's Rewards program matures, the purchase data will allow us to better understand the specific needs of each customer and tailor offers to their individual preferences. We're pleased with the early customer adoption and the successful launch, both in-store and online. And our frontline associates have also rallied around this campaign, and I'd like to thank them for their successful efforts to promote MyLowe's Rewards and educate our customers on the benefits.

Now speaking of the team, we're excited to welcome the best soccer player in the world, Lionel Messi to our Lowe's home team lineup. We're also extending our reach to more sports fans beyond the football fans we connect with as the official home improvement retailer of the NFL. We're now striving to reach the 34 million soccer fans in the U.S. who are not NFL fans and we're excited by the rapid growth of soccer fans in the U.S. This exciting alliance along with our partnership with MLS Club Inter Miami CF and the Copa America 2024 USA tournament gives us the opportunity to build trust and credibility with a broader customer base. These partnerships will help us bring new customers to Lowe's and offer some unique experiences and rewards for these very passionate fans.

Now I'd like to provide a quick update on our view of the macro. Uncertainty around interest rate cuts, stubborn inflationary pressures and a consumer still showing a preference towards spending on discretionary services and experiences continue to weigh on the DIY home improvement demand. And the outlook for lower mortgage rates and improved housing turnover remains uncertain. Real wage growth and home price appreciation are solid, but the home improvement customer is still on the sideline, expressing concerns about higher cost of living and the state of the overall economy.

And while the near term is still challenging to read, we remain confident in the medium- to long-term outlook for our industry as our core demand drivers are all supportive of growth. Our continued commitment on our PPI initiatives, combined with our ongoing investments in our Total Home Strategy not only allow us to perform efficiently in this challenging macro environment, it also positions Lowe's for accelerated market share growth when the home improvement market recovers.

Before I close, I'd like to extend my appreciation to our frontline associates for their continued hard work and commitment to Lowe's and to our communities. I've visited stores in 8 of our 15 geographic regions in the first quarter and our frontline associates are simply outstanding.

And with that, I'll turn the call over to Bill.

William P. Boltz - *Lowe's Companies, Inc. - EVP of Merchandising*

Thanks, Marvin, and good morning, everyone. In spite of a challenging home improvement backdrop in Q1, we are pleased with our early spring sales as customers responded to our strong spring assortment and compelling offers. And our improved brand and service offerings resonated with our Pro customers, which led to positive broad-based Pro comps across all 3 geographic divisions.

This year, our SpringFest strategy went more local than ever by using weather-triggered digital marketing as the spring season broke across different regions. In Q1, we also introduced sneak peaks for SpringFest, featuring doorbusters that were focused on driving traffic into our stores and online with targeted offers with seasonally relevant categories such as soils, mulch, and live goods. Winning the customer with these early seasonal purchases is important as they will often come back multiple times throughout the spring for the remainder of their outdoor project needs. Now turning to our results in hardlines.

These marketing efforts, paired with the right brands and strong execution helped us deliver positive comp sales on a 1-year and 2-year basis in lawn and garden. Growth was driven by smaller ticket projects in landscape products and live goods, which resulted in increases in both comp sales and transactions in these categories. We are also pleased to be gaining traction with our own Sta-Green private brand, as customers have responded to the quality and the value offered in these lawn care products. And Sta-Green helps provide the consumer with a beautiful lawn that they can be proud of at a price that won't break the bank.

For the first time this spring, customers can also purchase select plants and live goods online and have them delivered through lowes.com. Garden products are already some of the most searched items on our website and now customers can conveniently shop for what they need and even order them from their backyard. And as Marvin mentioned, we are excited about our powerful new spring outdoor power equipment lineup as we introduced Toro to our lineup this year.

Lowe's now offers the largest selection of Toro products of any national retailer with innovations like SmartStow, which allows owners to store their mower upright, reducing the storage footprint by up to 70%, including patented Briggs & Stratton technology, so it doesn't leak oil when stored in this position and with personal pace, a best-in-class self-propelled system that propels the mower at the speed the user is walking. We added these innovative Toro products to an already unmatched brand arsenal, which included EGO, SKIL, Kobalt, Husqvarna, CRAFTSMAN and John Deere. These strong brands helped us deliver positive comp sales in both gas and battery-powered walk behind lawn mowers as well as handheld outdoor power equipment. Now shifting gears to building products.

Our Pro customers remain busy, which supported positive comps in building materials, with strength in roofing, concrete and block, drywall, and insulation, all helping to fuel that growth. Our added focus on inventory depth and improved in-stocks along with our localization efforts with tailored assortments to the market, continue to give Pro customers the confidence that Lowe's will have what they need to complete the job. Repair

and maintenance categories such as water heaters, also continue to perform well, especially with innovative products like A.O. Smith's 120-volt plug-in heat pump water heaters. These Energy Star certified models plug into a standard wall outlet for easy installation and can save homeowners over \$600 a year in utility bills compared to a standard electric water heater.

In Electrical, we are pleased with the performance of Klein tools, the #1 tool brand for the electrical and HVAC professional. New products like the Klein circuit breaker finder, make it easy for electricians to quickly identify which breakers and outlets are connected to the breaker panel without turning the breaker on and off. The introduction and expansion of brands like Klein tools not only drive sales, it also allows us to rebuild the credibility with our Pro customers.

Turning to home decor, where softer demand in DIY bigger ticket interior categories like flooring, kitchens and bath and appliances persisted. Trends in these categories were largely in line with the results we saw in the second half of last year. Our customers continue to look for value, especially given the persistent inflationary pressures. And our private brand products provide them with both value and style as they look to refresh their homes. Products like our allen + roth Harlow kitchen faucet, which is simple to install with 3 easy steps. And what is really unique, you don't have to go below the sink to install it. Our STAINMASTER PetProtect carpet with leak defense backing helps prevent spills and keeps pet accidents from seeping through to the rug pad or sub floor. STAINMASTER is the most trusted brand in carpet and is exclusive to Lowe's. Turning to appliances.

We are expanding our market share as we continue to lead the industry with the broadest assortment, compelling values and fast and convenient delivery supported by our market delivery model, which creates a best-in-class fulfillment solution, including next-day delivery in most markets, which is an important option for a customer replacing a broken appliance. Average selling prices remain pressured as we cycle the reintroduction of pre-pandemic promotions across the industry as well as the continued slowdown in discretionary demand. Despite these near-term challenges, our appliance suppliers continue to improve selection with innovation and amazing new products.

A great example is the Lowe's exclusive GE Freestanding Range with easy wash, a range with the first of its kind removable oven liner that is dishwasher safe, making for easy cleanup. Moving on to merchandising productivity. Our teams are continuing to execute against our extensive perpetual productivity improvement or PPI road map. This quarter, I'd like to highlight the productivity benefits of one initiative, the progress we've made in expanding our private brand penetration.

The core focus of our private brand strategy is to offer our brand-agnostic DIY customers with style and quality at a great value. Not only do these products provide this for our customers, the product margin rates for our private branded products are typically significantly higher on average compared to the national brand counterparts. As we build out a compelling private brand portfolio from allen + roth decor products, and STAINMASTER products within flooring and paint to Sta-Green lawn care products to Kobalt tools, outdoor power equipment and storage solutions, we are delivering value to the DIY customer and productivity to the bottom line.

As I close, I'd like to extend my appreciation once again to our vendors for their ongoing partnership, in particular, their support of our merchandising services team. Our 30,000 MST associates keep our shelves stocked, execute resets and enable our Red Vest associates to spend more time serving our customers. We allocate 100% of our MST funds into this program and are pleased with the impact it is having on our customer experience and associate productivity. And I'd also like to thank our merchants for their hard work and dedication as they navigate this dynamic macro environment.

Thank you, and I'll now turn the call over to Joe.

Joseph Michael McFarland - Lowe's Companies, Inc. - EVP of Stores

Thank you, Bill. Good morning, everyone. Let me begin by thanking our frontline associates for their hard work this quarter. Customer satisfaction scores were up 100 basis points over last year as we continue to improve our shopping experience for homeowners and pros while at the same time, driving productivity across our company. As we improve our customers' experience, we also remain focused on our associates' experience and our journey to become the employer of choice in retail.

An example of our commitment to our associates was our decision to close our stores on Easter for the fifth consecutive year, giving our associates a well-deserved day off to spend with their loved ones, one of many ways we work to show our appreciation. We are seeing strong spring staffing

levels and higher retention as we continue to invest in wages, associate development and internal mobility. And we have a best-in-class leadership development training program, including a store replicate at our Lowe's University training center, which gives store leaders hands on leadership practice and coaching.

We have also implemented new weekly routines that help our department supervisors strengthen selling culture and skill set in their stores and prepare these leaders for their next step in their career. As a reminder, more than 80% of our store leadership positions were filled internally last year and nearly 90% of our store leaders started in hourly roles. Another way we are strengthening our selling culture is through our modernized store operating system, which is enabling our associates to close omnichannel sales from within our stores and help customers get everything they came for. So when a customer is looking for something out of stock or can't find the specific style they want in store, our associates can search our online assortment to find what they need and help them seamlessly check out an order that combines in-store and online items.

Beyond supporting sales, our store teams remain laser-focused on driving productivity. A common misconception that we are hearing is that Lowe's must be nearing the end of our productivity journey given how much progress we've made in the last 5 years. This couldn't be further from the truth. Since this can be hard to see from the outside looking in, let me share some examples. First, we are only 1/3 of the way through our multiyear transformation of the front end of our stores, which includes our proprietary self-checkout registers, a significantly improved buy online pick up in store experience, a streamlined returns process and an optimized front-end selling space.

Second, we have significantly reduced our return and cancellation rate through improved vendor partnerships, decreased damages and a clear and consistent returns process that's now systematically applied through enhanced technology. Third, we are also enhancing our shrink prevention ecosystem to maintain our best-in-class shrink performance including a new AI technology in partnership with NVIDIA that prompts customers to scan missed items during self-checkout. We're also piloting new product protection with a product security door that unlocks with the customer's phone number instead of needing to find an associate with a traditional key. These are just a few examples from our extensive road map of PPI initiatives.

Given the strong performance of our frontline associates this quarter, 93% of our stores qualified for our Winning Together quarterly bonus, which is designed specifically for our hourly associates. As we approach Memorial Day weekend, I want to thank our veterans. As a marine, I'm proud of our company's long-standing commitment to supporting our military community. Lowe's ranks among the top military-friendly brands in the U.S. with a 10% off every day military discount, dedicated veteran parking spots and nearly 26,000 associates from the military community.

We work with Department of Defense to bring our jobs directly to transitioning service members and military spouses and have a program to provide training and work experience with Lowe's during their last months of service. We value the skills, dedication and courageous leadership we see in our veterans. And this Memorial Day, I hope you will join us in thanking our associates in camouflage vests for their service. In closing, we are executing to deliver an even better experience for our customers and associates, while unlocking even more productivity across our stores.

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

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Thank you, Joe. Starting with our first quarter results. We generated GAAP diluted earnings per share of \$3.06. Please note, in Q1 last year, we recognized a gain of \$63 million associated with the sale of our Canadian retail business. As a result, my comments today will include comparisons to certain non-GAAP measures from last year.

First quarter sales were \$21.4 billion with comparable sales down 4.1% as improved seasonal weather, combined with strong spring execution drove better-than-expected results. Comparable transactions declined 3.1% as homeowners continue to delay larger discretionary projects. And comparable average ticket was down 1%, with strength in Pro, partly offsetting the impacts of lower DIY bigger ticket sales and ongoing appliance pricing pressure. Our monthly comps were down 6.7% in February, 4.9% in March and 1.1% in April.

Keep in mind, our monthly comp cadence was impacted by the earlier timing of Easter, which fell in March this year while it was in April last year. Because we closed our stores on Easter, this pressured our March results by approximately 300 basis points and benefited April by the same amount.

Gross margin was 33.2% of sales in the first quarter, down 49 basis points from last year, largely driven by ongoing supply chain investments, early spring traffic driving promotions and a modest decline in credit revenue. This was partly offset by lower transportation costs and ongoing PPI initiatives.

SG&A was 18.8% of sales, down 137 basis points versus last year's adjusted SG&A driven by sales deleverage as well as the cycling of a favorable legal settlement. These pressures were partly offset by PPI initiatives delivered by each functional team across the company. Operating margin of 12.4% declined 201 basis points versus prior year adjusted operating margin. The effective tax rate was 23.7%, largely in line with last year's adjusted effective tax rate. Inventory ended the quarter at \$18.2 billion, \$1.3 billion lower than last year as we continue to optimize replenishment to align with sales patterns and improve the efficiency of spring product flow. Turning to capital allocation.

In the first quarter, we generated \$3.9 billion in free cash flow. Capital expenditures totaled \$382 million as we continue to invest in our strategic growth initiatives. We paid \$633 million in dividends at \$1.10 per share and repurchased 3 million shares for \$743 million, returning \$1.4 billion to our shareholders. We ended Q1 at adjusted debt to EBITDAR of 2.93x, and we delivered a return on invested capital above 32%. Looking forward to the remainder of the year, today, we are affirming our full year 2024 outlook. We continue to expect sales ranging from \$84 billion to \$85 billion and comparable sales in a range of down 2% to down 3% with Pro sales outpacing DIY.

We expect operating margin in the range of 12.6% to 12.7% and full year earnings per share of approximately \$12 to \$12.30. To assist with your modeling, here are a few points to keep in mind for the cadence of the year. First, based on the trends we are seeing in the business, we expect second quarter comparable sales to be roughly in line with the first quarter. We continue to expect second half comp sales to improve as we cycle over easier compares from the DIY pullback that intensified in the third quarter of 2023. As I mentioned on our last call, this is not because we are forecasting an improvement in demand trends this year, it's just that the compares are easier in the second half.

In terms of flow-through, we expect operating margin to remain under pressure in Q2, largely due to sales deleverage and cycling a favorable legal settlement. Taking these factors into account, we expect Q2 operating margin rate to be approximately 150 basis points below the prior year rate and flow through of productivity to improve in the second half of the year.

Before I close, I'd like to reiterate that our capital allocation strategy remains intact. First, reinvest in the business; second, target a 35% dividend payout ratio and third, return excess cash to shareholders through share repurchases. In 2024, we plan to use our free cash flow to repay a \$450 million bond maturity and then return the remaining cash to shareholders through share repurchases. In closing, we remain focused on investing in our Total Home Strategy. As Marvin mentioned, we are also executing against a multiyear road map of PPI initiatives, which will continue to unlock productivity well beyond 2024. We are well positioned to capitalize on home improvement demand when the market recovers and continue to deliver sustainable shareholder value.

And with that, we'll open it up for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Chris Horvers with JPMorgan.

Christian Justin Carlino - *JPMorgan Chase & Co, Research Division - Research Analyst*

It's Christian Carlino on for Chris. Just to dig in on the gross margin. Could you help us understand some of the drivers there? And are you seeing the full run rate of vendor clawbacks at this point? Or does that build over the year. And just broadly, how should we think about the phasing of gross margin expansion over the year relative to the flat gross margin guide?

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Yes, sure. This is Brandon. Thanks for the question. So as it relates to gross margins, and we look out for the full year, we are still expecting gross margins to be flat. Our improvements, mainly PPI, we expect those to be more back half weighted. The headwinds, we had many of these in Q1, ongoing investments in our supply chain as we finalize the rollout of market delivery, early investments in our Pro fulfillment initiatives, and spring promos as we continue to execute on our everyday competitive pricing strategy.

And then the tailwinds, a number of PPI efforts that we continue to execute against, Bill mentioned momentum that we're seeing in private brands, ongoing pricing initiatives. And then as it relates to the clawback, we're making really nice progress there. Driving sales now. We're making some of that investment in price, and there's going to be a bit of a lag defect as the new costs turn through inventory here over the next 3 quarters and then also continuing to benefit from lower transportation costs as we leverage our scale to drive rates with our carriers.

So we also mentioned credit is some first half pressure there related to higher borrowing costs and delinquencies as it relates to our private label credit portfolio, but we expect to be able to manage that roughly flat to the year and then great performance on the shrink side. We continue to expect roughly flat on the year there.

Christian Justin Carlino - *JPMorgan Chase & Co, Research Division - Research Analyst*

Got it. That's really helpful. And I appreciate the color in the prepared remarks, but I guess, how would you disaggregate some of the bigger ticket trends between more remodeling oriented categories that are more likely financed versus others like big ticket seasonal and appliances, and how are you thinking about the recovery path for maybe these 2 sides of big ticket broadly?

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Yes. I think when we look at big ticket in particular, we continue to see pressure, right? We called out large tickets greater than [500], down 7.6% for the quarter. Most of that right now is still related to DIY, and we're continuing with the Q4 trends that we saw there where big ticket was down 8.8%. I think a lot of that is as we look at discretionary, there is some seasonal impact there as we continue to see some level of pressure from patio, from grills with multiyear replacement cycles. We are continuing to see pressure from appliances as we normalize against the promo environment, we get back to more 2019 levels.

And then also the emerging dynamic with the lock-in effect and higher rates continues to pressure big ticket categories like kitchen and bath, decor and flooring. And those are categories that are sensitive to higher interest rates and the new home occasion. So very much working through that. We're seeing offsets to that with as we continue to drive the Pro business, and that helps boost some of our big ticket. We expect that average ticket for the full year to continue to be roughly flat, but definitely continuing to work through some of the DIY pressures that we're experiencing.

Operator

Our next question is from the line of Steven Forbes with Guggenheim Securities.

Steven Paul Forbes - *Guggenheim Securities, LLC, Research Division - Analyst*

Marvin, maybe a question for Joe actually on the front-end transformation. I was maybe curious if you could just update us on how you're sort of thinking about the ROI of that initiative. It sounds like it's progressing and we're only 1/3 of the way through. But any color on sort of what the comp lift is or the waterfall benefit we should sort of think through as we work through the whole transformation here?

Joseph Michael McFarland - *Lowe's Companies, Inc. - EVP of Stores*

Yes. And so thanks for the question, Steve. I won't give the comp benefit, but there are several things that we're seeing. We have a detailed road map that we've laid out. We're 1/3 of the way through. And when I think about the proprietary self-checkout systems we talked about in the past, the user-friendly for the home improvement customer along with the partnership we have with our tech team under Seemantini's leadership, the teams work hand-in-hand. So we're incorporating the technology that we spoke about, NVIDIA, our assisted self-checkout. And in addition, we just finished launching the ability for our gig drivers to pick up from our enhanced buy online pickup in store and all of our gig delivery network. So we're really pleased. And again, third of the way through customer satisfaction scores have improved, the associate engagement has improved and very pleased with where we're at.

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

And Steve, I'll just add, you mentioned we're only 1/3 of the way through, but we're really pleased with the benefits that we're seeing. We're not going to call out the comps, but just financially speaking, seeing higher sales as we're opening up space on the front end, lower payroll costs, improved returns as we've increased or improved that experience and then the customer experience with the improved front end and BOPIS. So just as we look at all of our KPIs there, 1/3 of the way in, we're pleased with the progress there.

Steven Paul Forbes - *Guggenheim Securities, LLC, Research Division - Analyst*

And maybe just a follow-up, as we approach Memorial Day here and think through categories like appliances and the change in the promotional sort of strategy away from bundles and sort of to a buy more, save more strategy. What are you sort of expecting from the consumer in terms of engagement and conversion? Like, is there any early reads that you're seeing or anywhere -- any way to sort of talk through how you sort of expect the consumer to engage here over the coming weeks?

William P. Boltz - *Lowe's Companies, Inc. - EVP of Merchandising*

Yes, Steve, this is Bill. And so the trends we're seeing with appliances are very similar to what we've been seeing really over the last 6 to 12 months in that we've seen the consumer shift from buying multiple pieces to now single item pieces really in that [duress] market. And so that's where we've pivoted our efforts to making sure that we're meeting her where she wants to be met. And we're really pleased that we've continued in a down market to be able to drive units and pick up unit share during that time frame.

And so that's the efforts that you're going to see us drive as we go through Memorial Day and throughout the remainder of the year. And when you look at what the appliance team is doing, we're also seeing great innovation, as I called out in my prepared remarks with a GE oven that I talked about. But we've also talked about it before, you're seeing wherever we're putting innovation on the floor, you're seeing her respond to that type of product. And that's really the difference that's going on today. You've got a value-conscious consumer that is opting in and you've got a consumer that's not afraid to pay for innovation when that's offered to her as well. So we want to make sure that we meet her where she wants to be met.

Operator

Our next question is from the line of Simeon Gutman with Morgan Stanley.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

I want to talk about the backdrop and any signs of normalization. If you can talk about traffic versus '19, I know big ticket is part of there, is that third year of negative comps. And I guess we are going to -- I guess, the model says we're going to see a turn by the end of the year. But Brandon, you mentioned that's not macro dependent. That's more business dependent. So curious. And also, by the way, part of that is if there's a category that you're paying attention to that gives you a leading indicator of anything that's turning.

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Yes. Simeon, just as it relates to the macro first, we ultimately need to see customers, consumers reengage for us to have confidence that the home improvement is inflecting. We're watching for an uptick specifically on discretionary bigger ticket projects. I mentioned earlier what we're seeing. We're not seeing that at the moment. I think we're watching consumers continue to digest and adjust to the monetary tightening, which is working its way through the system, and that continues to have an outsized impact on housing where we see affordability challenges and historically low turnover.

So again, we're not seeing that inflection point. Consumers continue to kind of remain on the sidelines. As Marvin mentioned, and we're waiting on that catalyst. We don't necessarily expect or understand any of the timing of that. But just as it relates to the comp cadence, when we look at the second half, this is about the improvement in second half, not an improving macro, as I said in my prepared remarks. It's just easier year-over-year comparisons. And we looked at this in a number of different ways, tops down, bottoms up across multiple time frames. We've looked at DIY Pro categories and geographies, and we feel comfortable, sort of the down [4] over the first half and moving back to a more historical mix of transactions and ticket as we start getting into the back half of the year.

Marvin R. Ellison - *Lowe's Companies, Inc. - President, CEO & Chairman*

Simeon, this is Marvin. The only thing I'll add is more of a broader theme that we're focused on. And that is managing through any unique challenges we're facing today. And I think Q1 reflects that we're executing at a high level in spite of some of the macro headwind that we're dealing with. But we're really positioning ourselves to really come out of this downturn as a much better company. We've invested billions of dollars in supply chain, IT infrastructure, our digital platform, our omni systems, store environment, merchandising assortments.

And in other words, whenever the macro decides to turn, we're going to come out of it as a much stronger, more productive company. And so although we can't predict when that's going to happen, Brandon outlined our commitment to our capital allocation strategy, we're going to continue to invest, we're going to continue to make sure we prepare ourselves. And whenever the positive trends start to show up, we're going to be ready for it and we're going to take full advantage of it.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

Related to that, Marvin or Brandon, incremental margins when the business turns, is there a case to be made that you spend into an upturn faster than what you're spending now? Are there places that you've held back on such that incremental margins aren't, I guess, typical cycle coming out into a housing recovery?

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

No, Simeon, I would say we've been fully committed to our long-term road map in terms of capital, major projects and PPI and top line growth initiatives still been fully committed to that. But we haven't pulled back at all. And as Marvin mentioned, we're investing in the business for the long term. Committed to the long-term trajectory and looking forward to comps starting to turn whenever that may be, and we believe kind of a long-term algorithm holds in place once that happens.

Operator

Next question is from the line of Michael Lasser with UBS.

Michael Lasser - UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines

Given the state of the home improvement cycle, how are you currently looking at the trade-off between driving sales and market share versus sacrificing gross margin, understanding that you expect your gross margin to improve over the course of the year, are you more willing to make this trade-off now with the view that it will be a benefit as the cycle recovers?

Marvin R. Ellison - Lowe's Companies, Inc. - President, CEO & Chairman

Michael, I'll take the first part of that. This is Marvin, and I'll let Brandon give some additional perspective. I think Bill said it best. We're trying to meet the customer where the customer currently is at. And if the customer is looking for value, value does not always equate to low price, it equates to a great return for the dollar you spend. And so we feel really fortunate that we can make early investments in the customer with events and activities to win that early spring customer and still have an opportunity to outperform earnings per share and operating margin.

And then as Brandon mentioned, we have initiatives in place that give us confidence that we'll roughly recover any gross margin decrement in the back half and end the year relatively flat. So we're going to be able to pull all the levers we have to make sure that we can aggressively serve the customer well. And we believe in a very simple philosophy, and that is during the spring season, if you win the customer early, you get multiple shopping occasions throughout the spring and the year and Bill and his team, along with great execution in the stores and the supply chain allowed us to do that. And so that's the overreaching philosophy, then I'll let Brandon give you more specifics on how we think about it for the balance of the year.

Brandon J. Sink - Lowe's Companies, Inc. - Executive VP & CFO

Yes, Michael, I would just add, as Marvin said, we were really pleased with our ability to pivot our go-to-market strategy, especially as we saw customer behavior start to change over the back half of last year and our execution, our marketing approach, how we highlighted value, we believe, helped us win Q1, and we did see a little bit of margin pressure from those actions, but really pleased that we were able to manage that and offset that within SG&A and still deliver the bottom line number and I think confident that we can manage the portfolio as we move through the balance of the year.

You mentioned we do expect some of these gross margin pressures to start to tail off as we move through the year in PPI to start to accelerate. So we're committed to delivering both the top line and the bottom line in line with our guide.

Michael Lasser - UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines

Okay. My follow-up question is on the DIY loyalty program. What has been the lift that you've experienced from that -- from rolling that out so far? And what do you expect to see over the course of the year? It seems like given the performance in the first half, while there are easier comparisons in the back half you're probably embedding some contribution from this factor in order to get to the full year guidance?

Marvin R. Ellison - Lowe's Companies, Inc. - President, CEO & Chairman

Well, Mike, this is Marvin. We're not going to get into the specifics of the lift. But as I remind you and everyone, we launched the program in March. The initial focus was on enrollment, getting active members engaged, app downloads, and we're really pleased with how well it is going. The rollout was very smooth, and it really spotlights the benefits of really modernizing our store operating system. We could not have rolled this loyalty program out a year ago. because we were still in the process of retiring a 30-year operating system, which is now for all intents and purposes, behind us and the store associates engagement was simply tremendous in educating the customer and making sure that they were articulating the value.

So our objective is just to simply take the data to serve our customers more effectively. Data is a new currency, but it's only beneficial if you use it to benefit the customer experience. We think we'll be able to do that. And we're also believing that we'll be able to get additional trips from the

customer throughout the year. It's early, but we're pleased with the results, and we'll look forward to updating you and the external community throughout the year on the progress we're making.

Operator

Our next question is from the line of Greg Melich with Evercore ISI.

Gregory Scott Melich - *Evercore ISI Institutional Equities, Research Division - Senior MD*

I wanted to follow up on the comp cadence. It sounds like still some macro pressures. If you look at the comp you just reported, the negative [4] and you're doing negative [2 to 3] for the year. How much of that improvement is coming from ticket cycling what was happening a year ago versus traffic improvement?

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Yes, Greg, this is Brandon. The majority of that's going to be traffic related. I think as I'll get the breakdown across the year on ticket and transactions, we're, for the most part, expecting average ticket to hold, consistent over the course of the remainder of the year just as we saw here in Q1, some slight pressure, ticket related, as we've shifted down in the smaller ticket seasonal projects, which has boosted transactions. And then we're also seeing continued ticket pressure, as I mentioned, from the DIY big-ticket discretionary and that includes some of the appliance promo pressure. But the flip side is, Pro growth continues to run strong for us, which is helping mix ticket up.

And then as we look at really the second half of the year and the cadence improve, again, it's a function of really what we're cycling and we expect the transactions to start to pick up as we accelerate into the second half of the year, and we're going to see again, a much more historical relationship between ticket and transaction over the course of the second half of the year.

Gregory Scott Melich - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Got it. And then a follow-up on the gross margin. It's still flat for the year, but you'd expect it to be down in the second quarter similar to 1Q and then up 50 bps in the back half. Is that the right way to model that?

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

I won't put a specific number on Q2, but we do expect Q2 to be similarly pressured with supply chain investments and some of the credit pressure that we're continuing to see. But for sure, as we get into the second half, we're seeing the improved -- the acceleration of PPI flow through with some of the supplier clawback cost out. There's some timing benefits that will come through in the second half of the year and then some of the credit pressures just start to ease. Again, that's a cycling, a timing issue as we started to see some of the interest rate pressures and delinquencies started to pressure in the second half of last year. So we expect that to smooth out as well. So that's sort of the shape of the curve there.

Gregory Scott Melich - *Evercore ISI Institutional Equities, Research Division - Senior MD*

I may have missed it, but was the new reward program part of the gross margin pressure in 1Q or no?

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Not significant at this point, just given the timing of when we scaled that.

Operator

Our next question is from the line of Seth Sigman with Barclays.

Seth Ian Sigman - *Barclays Bank PLC, Research Division - Research Analyst*

I want to talk about how the quarter played out. So the quarter started off weaker as you reported originally. And then you did see an improvement came in ahead of forecast. How do you think about how much of that was driven by seasonal versus maybe some other areas that could have come in a little bit better?

Marvin R. Ellison - *Lowe's Companies, Inc. - President, CEO & Chairman*

I'll take the first part, and then I'll hand it over to Bill. I mean this was broadly a weather dynamic from a standpoint of how the sales flow. We feel really good about the execution. We feel great about some of the initiatives with SpringFest and how the customers respond to it. But the cadence was really driven by the impact of weather to the initiatives. I'll let Bill kind of walk through some of the specific initiatives and how it played out in Q1.

William P. Boltz - *Lowe's Companies, Inc. - EVP of Merchandising*

Yes. Thanks, Marvin. And Seth, I think the big difference for us this year is that we took a slightly different approach to our marketing. We -- as I said in my prepared remarks, we took a geo-targeted approach, which was really going south to north with our SpringFest campaign. And we put some offers out there that were seasonally relevant. We were able to target those south to north. And then we got a little bit of weather favorability that happened in March, and then we carried that into April. We're able to navigate some storm weather. We took advantage of that. But the teams did a really nice job of making sure that we had new products, new brands.

We saw Toro really respond well for us. We continue to see EGO perform well. We continue to see anything that we've done, as I said earlier, in a question that was asked earlier around innovative products perform well. We've seen the consumer respond now with the weather advantages, the grass is growing. So they're out there buying zero-turn riding mowers. They're buying full-size gas grills. So we're seeing that work. And now we've got -- as we go into Q2, we've got Memorial Day, July 4, Father's Day in front of us. So we've got to take advantage of those events as we finish out the quarter. So those are really the results.

And where we've had weather, we've seen it play in our advantage. And the lawn and garden team, as I said, had really nice results in the first quarter, driving that with traffic-driving events with soils, mulch, live goods and they took advantage of that customer that was out there getting their yard ready early in spring. So that was really the drivers.

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Seth, this is Brandon. Just one more thing. Just as you recall at the beginning of the year, we did plan Q1 for a much more normal spring season, and we had called out the last 2 years about a \$400 million drag related to unfavorable weather in the last 2 years. So cycling against that. Some of that recovery moved into Q2 over the last couple of years. So that's also embedded into our outlook as we're looking at Q2 for this year.

Seth Ian Sigman - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Got it. That makes sense. Just a related question on the improvement that you saw in the Pro business going back to positive this quarter. Obviously, there's a lot that you're doing to drive that. But any sense whether that reflects market share gains or just broader improvement in some

of those Pro-oriented categories? And I guess, any perspective on if your performance is coming from customer growth or wallet share and just any context there?

Marvin R. Ellison - *Lowe's Companies, Inc. - President, CEO & Chairman*

Well, I think overall, we're very pleased with the performance of our Pro strategy. As you know, it's been a 5-year investment journey on things like investing in job-like quantities for inventory, improving service levels, adding national brands, Bill and I, both mentioned the great performance of Klein tools, the #1 brand for electricians and HVAC professionals, bringing brands like that to the assortment, it just adds to the credibility of the turnaround that we've been on and trying to win some of these customers back from years past, in addition to a stronger digital platform, a great loyalty program that's resonating with the customers.

And from the survey results that we shared, I mean, this is a resilient customer that continues to fight through the economic headwinds and their backlog is relatively equal to last year. So overall, that's driving it, whether or not we're taking share or not is, look, we don't want to determine that as much as we're just looking at internally at just much improved execution and results. And I'll let Joe talk a little bit about some of the other initiatives that were driving that. That we think is really resonating that allowed us to get this business back to positive.

Joseph Michael McFarland - *Lowe's Companies, Inc. - EVP of Stores*

Yes. Thanks, Marvin. Seth, as you think about some of the investments that we've made, Marvin has called them out, Bill has called them out. Job-like quantity, safety stock, but also our enhancement in our job site delivery for larger orders. If you think about the maturity of our loyalty program in Pro, our CRM program, our growing share of wallet. We continue to expand our Lowe's Pro supply. And then from the survey that Marvin had mentioned, the dimensions of the [health], we look at backlogs and materials, credit, labor and the project type. The Pros have been stable and steady there. And so we're pleased with the gains we're making with this customer, both in-store, product-wise and online.

Marvin R. Ellison - *Lowe's Companies, Inc. - President, CEO & Chairman*

And Seth, I'd just close the Pro discussion with just one additional point. We're really focused on the customer that we can serve at a very high level and that's that small to medium Pro. And we estimate that's a [\$200 billion] market opportunity. And so we are focused squarely on that customer. That customer still leverages the store. For fill in we can leverage the productivity of our existing real estate footprint to serve that customer well. We can do it without having to make dramatic investments in operating expense in addition to the fulfillment capabilities, as Joe talked about. So we are very confident that our strategy is working and that is reflected in the results. We still have other investments to make, we'll make them, and we hopefully will continue to see this business head in the right direction in spite of a very difficult macro.

Operator

Our next question is from the line of Peter Benedict from Baird.

Peter Sloan Benedict - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I guess just on the DIY loyalty program, I know it didn't have much of an impact on the P&L here in the first quarter. But just curious how we should think about that longer term as it scales? And maybe a comment also on the associated lift in the private label credit sign-ups, what you're seeing there, what that means, I guess, going forward, any perspective on how private level credit has been for you guys historically and what's maybe possible here with this new program?

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Peter, thanks for the question. This is Brandon. Just -- again, Marvin hit on this a bit, but our goals overall with the loyalty program are to create further stickiness with our DIY drive repeat visits and spend over time, our ability to get the data and drive more personalized marketing. Super pleased with what we're seeing with engagement from the customer standpoint and our associates. We're managing the enrollments to membership, points, redemptions.

You mentioned sort of financially we're targeting effectively one more trip annually from our DIY customers. That's the revenue upside as we see it, and it's going to take some time to gauge success of that. So we're going to have to watch that play out over the course of the year. And then in terms of the overlay with the credit program, I mean, we are bundling and building on top of a 5% credit offer that we believe is best-in-class. It's going to continue to drive increased penetration there, and we think that value really resonates with the customer, and we're able to make that work financially. So we think it's a win-win there.

Joseph Michael McFarland - *Lowe's Companies, Inc. - EVP of Stores*

Peter, to add on Brandon quickly. We're pleased with the first kind of loyalty perk that we rolled with Mother's Day, the engagement we had with the members and new members as well as our associates and our ability to gain incremental loyalty members. And so as an early example there, the Mother's Day engagement, we're very pleased with.

Peter Sloan Benedict - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

That's great. And then I guess my follow-up would be just around -- just the plans for the go-to-market strategy over the balance of the year. I mean it clearly sounds like you guys took some steps here during the spring to capture some incremental business. As you think about the back half of the year, have you layered in additional, I guess, events or promotions to kind of help get those comps -- that comp trend improved. If not, is that a lever you think you'll need to pull or be willing to pull? Just kind of curious how you're thinking about the balance of the year, the second half of the year with respect to promotions.

William P. Boltz - *Lowe's Companies, Inc. - EVP of Merchandising*

Yes, Peter, it's Bill. And so the promotional environment remains stable. And so nothing radically crazy. We're going to go similar to what we've been doing. We want to be seasonally relevant as we go into the back half of the year, obviously, we'll be out there as we go into fall with Labor Day. We're going to introduce Halloween. We're going to make sure that we're relevant with holiday and gift center and introduce and set our stores for spring in the Deep South for that December-January time frame. But we're going to make that transition.

We're going to be relevant as the consumer comes out of those key seasonal categories, we'll make that transition into those fall seasonal categories, but there won't be anything goofy that will happen in the second half of the year. And so that's how we're going to approach it.

Operator

Our final question comes from line of Jonathan Matuszewski with Jefferies.

Jonathan Richard Matuszewski - *Jefferies LLC, Research Division - Equity Analyst*

First one, I wanted to dig into regional trends. Some peers have been calling out less worse trends in the West. It was one of the first regions to enter the housing recession. So are you seeing less worse trends there? It looks like this year 6 of your [15] geographic regions outperformed the company average. So any more detail in terms of regional variability that you're seeing would be helpful. That's my first question.

Joseph Michael McFarland - *Lowe's Companies, Inc. - EVP of Stores*

Jonathan, this is Joe. Thank you for the question. From a geographic standpoint, as we said, where we've seen great weather, we've seen great performance. But from an overall and geographical standpoint, our West is our best performance for Q1.

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Yes. And Jonathan, I would just add, consistent Pro outperformance across all of our regions. So really pleased with that. And then conversely, pretty much uniform ongoing pressure in DIY big-ticket discretionary. So that's been pretty broad-based on both the Pro side and the pressure and no real differences in what we're seeing across regions.

Marvin R. Ellison - *Lowe's Companies, Inc. - President, CEO & Chairman*

Yes. I think the only comment I will make, Jonathan, is that our rural stores continue to be our best performing subset of stores within the overall geography and some of the initiatives that Bill's teams initiated with pet and apparel continue to perform really well in those locations, and we continue to evaluate the expansion of those categories in our rural environments. But overall, the West outperformed. As Brandon mentioned, Pro was widespread at a really strong performance. And the rural set of our stores kind of is the high watermark in performance among all geographic locations.

Jonathan Richard Matuszewski - *Jefferies LLC, Research Division - Equity Analyst*

That's really helpful. And then just quickly, just to circle back on big ticket. I know there were some questions earlier. Just to be clear, what does the midpoint of your annual comp guidance embed for big ticket, right? So over [500] transactions were down around 7.5%. So does that 2% to 3% comp decline for the year require sequential improvement in year-over-year declines for purchases over 500 or are you expecting that to basically continue throughout the rest of '24.

Brandon J. Sink - *Lowe's Companies, Inc. - Executive VP & CFO*

Yes. Again, Jonathan, I think just on an absolute dollar performance standpoint, we're expecting more of the same in terms of what we saw second half. We don't have any macro improvement sort of embedded in. So from an absolute standpoint across these categories, we're expecting similar performance as we move through the year, but the comps should improve significantly in these categories just again based on what we're cycling and when we started to see the downturn in the second half of last year.

Kate Pearlman - *Lowe's Companies, Inc. - VP, IR & Treasurer*

Thank you all for joining us today. We look forward to speaking with you on our second quarter earnings call in August.

Operator

Thank you. This concludes the Lowe's First Quarter 2024 earnings call. You may now disconnect.

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