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LOW.N - Lowe's Companies Inc at Morgan Stanley Global Consumer & Retail Conference

EVENT DATE/TIME: DECEMBER 05, 2023 / 1:45PM GMT

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PRESENTATION

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

Okay. We're going to get started. Hi, everyone. I'm Simeon Gutman, Morgan Stanley's hardline, broadline and food retail analyst. It is my pleasure to welcome Lowe's to this conference, represented by Chairman, President and CEO, Marvin Ellison.

As many know the story, it's been one of the better retail stories over the last several years. Marvin has been engineering a transformation. We don't call a turnaround anymore over the last number of years. And it still remains 1 of the least expensive or at least demanding large-cap companies in consumer retail. I'm kind of waiting for the next cycle to turn to see how this business can continue to transform both the sales and margins, read a quick disclosure, and I'm going to sit down in chat with Marvin.

For important disclosures, please see the Morgan Stanley research disclosure website at www.morganstanley.com/researchdisclosures. If you have any questions, please reach out to your Morgan Stanley sales representative. Thanks for being here.

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

Yes, absolutely. Pleasure.

QUESTIONS AND ANSWERS

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

Yes. Thanks for attending. So my first question, I think I'm going to start this with most companies looking back at '23, what surprised you questions? What's gone to plan, what hasn't gone as well?

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

Well, I think it starts with our Total Home Strategy where we are focusing on Pro, elevating our assortment online installation services and localization. So if you take the Total Home strategy as an overall theme to your question, I would say we're most pleased in and least surprised with the demand we are seeing in the Pro business. Our core Pro customers are small to medium-sized pro. And we've improved the penetration in that business from 18% of our sales when I started back 5 years ago to something now north of 25%, and we still have work to do.

But the demand we're seeing in that business and the fact that we've been positive comping each of the last 3 quarters in this year in a very tough overall housing environment says a lot about the strategy and about the resilience of that customer segment. We're also pleased when we look at how we've been able to drive productivity. I mean we've made the right investments in supply chain, IT infrastructure. And as a result of that, we've been able to drive improvement in operating margin, improvements in margin rate. Any time you can have a negative sales environment and still leverage operating margin to the degree we did in third quarter gives me confidence that those things are working. And it goes back to the overused phrase, controlling what you control, and we've done a really nice job of that.

Tied to that is the overall improvement in customer service with -- in the most recent quarter, 200 basis points improvement in the do-it-yourself customer and 300 basis points in Pro. And so all of those things have been not necessarily pleasant surprises, they've been a reaffirmation that the Total Home strategy is working. When we look and take a step back at kind of what was a little bit more of a surprise we did anticipate, I would say, the discretionary pullback in the DIY customer segment. We knew we would run into some degree of pullback in '23 but candidly, it's been a little bit more pronounced than what we anticipated. And as a perspective, roughly 75% of our revenue is a DIY customer. And as an example, 14% of our total revenue is in the appliance category.

And so we saw customers transitioned from a few years ago buying an entire appliance suite to now just maybe just buying a refrigerator as an example of that discretionary pullback happening with the DIY customer. Now the customer is still healthy, the customer just has a broader selection of things they're spending their dollar on, whether that's travel, entertainment, et cetera. And so we're having to fight for our fair share of that spend. And I would say that, that has impacted us in some regard. But even with that in mind, we still are very bullish on the medium to long-term outlook for not only Lowe's but for home improvement sector overall.

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

But they bought those big blow of dolls for Halloween and they're buying for Christmas, and I wanted to kind of ice break a little bit and ask you about Black Friday, if I may. And how that ties into discretionary and what you're seeing?

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

Well, overall, I'm pleased with the Black Friday weekend and specifically, the demand we saw from our consumers for appliances, gifting items, tools and just holiday overall. And so we're pleased with what we saw in-store and online. What's interesting is the entire omnichannel infrastructure that we've established in the company is starting to pay off. A point in case, we have certain markets where you can go in and have your family tradition to pick your live tree and then we can deliver to you same day.

And that's unique way of saying, celebrate the season in a traditional way with we're going to have a modern process in which we can get that tree to you a lot safer than strap into the roof of your car, and we can do it in some cases, within a couple of hours. And we're seeing customers respond and resonate really well to those types of enhancements to how we serve them.

Now although we're pleased with the Black Friday weekend, pleased with the customers' response to value and appliances, there's still a lot more gifting and bigger selling events in front of us. And so we are going to continue to execute well. But again, if I take a snapshot at Black Friday, we feel good about what we saw.

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

Macro, which I'm sure is 50% of the questions on all of our conference calls, still pretty fluid. Housing is going through a bottoming in terms of rate of change, rates are still high. How do you think about the macro for housing and demand for 2024?

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

Well, I think it's important to answer that with what's the greatest correlating factors in the macro to the Lowe's business. And historically, it's been personal disposable income, home price appreciation in the age of homes. And so if you take those 3 things and again, when those things work in concert together is when we see the greatest impact. So let's start with age of homes. I mean the medium age of homes today is roughly 41 years old is the oldest in the history of the U.S. And the one thing that we know is when homes get old, things break. And those things are -- they are nondiscretionary. I mean these are things like your roof leaking, your water heater needs replacing and appliance needs to be replaced.

When you look at personal disposable income, even in a tougher macro environment, it's still at elevated levels versus what we've seen in the past and home price appreciation, I think, for our core consumer, I mean our customers have over $350,000 in average equity in their homes. And so those things from a macro standpoint gives us confidence in the medium to long term. And that's why when we say we're bullish on Lowe's and bullish about home improvement, medium to long term, is because those factors are relevant. And those factors are not going away anytime soon.

What we're dealing with now still is the discretionary spin of the do-it-yourself customer being a little bit more cautious, and as I said earlier, that has a disproportionate impact to our business because roughly 75% of our consumer base is a DIY customer. So if you take a snapshot right now, that customer remains cautious that discretionary spend is still something that we're managing through. But as we look over the longer term, in the medium term, we feel really good about home improvement, and we feel even better about Lowe's because of the investments we've made in IT, in supply chain, in digital and in productivity initiatives that continue to pay off.

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

Just to build on that theme and maybe beat it down a bit. The '23 comp guidance minus [5%]. It's a bit below the weak market scenario. And you mentioned some of the discretionary. The question is, what has gone different with -- relative to that plan?

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

Yes. And I think that's it. I mean if you want to sum it all up is that we're seeing a more pronounced pullback in DIY discretionary spend than what we anticipated. And even though that is the case, I feel incredibly positive about how we've been able to manage that in this environment but that sums it all up. We've delivered positive sales growth in Pro. We feel good about our online performance but that DIY discretionary spend, specifically when you think about, as I mentioned earlier, 14% of our revenue is in a category like appliances. We have big sales volumes in categories like flooring and kitchen and bath.

And so the good news is, although we're not seeing the big ticket spend that we had anticipated in-home improvement, these projects are typically postponed in that cancel. And so we have a degree of confidence that the investments we made will pay off over time. But again, if we take a look at the environment now and what we not anticipate it was the severity of discretionary pullback from the DIY customer, and that's been reflected in those categories being under pressure that I just talked about.

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

You mentioned the word postponed. And some of these remodeling indicators would suggest still choppiness ahead. Is there any way in which we can get confidence that the fourth quarter, for example, not to pin you to the fourth quarter, represents then the bottom for this cycle.

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

It's a fair question. It's hard for me to give you a time horizon on what we think the bottom is. Look, we hope that the fourth quarter is the bottom but I can't definitively say that, that's the case. What I can tell you is that when we did our most recent survey of our professional customers, roughly 70%, 7-0 percent of them said that they still have a healthy backlog of projects that they're working on but they did also state that based on what they're hearing and seeing about the macro, they're a little bit more cautious today than they were maybe 3 months ago.

And that's to be expected. So the small to medium Pro is busy, they have a backlog, and I think that's driven primarily by the age of housing stock that we talked about. But it's hard for me to say here today and give you definitive that we're at the bottom. I mean, we hope that we are. We'll have a much better perspective as we get to the holiday season, and we get into January. And as you know we made a commitment on our most recent earnings call to when we have our fourth quarter call in February, we'll provide guidance and we'll be as transparent as we can be based on what the economic indicators are informing us.

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

Transition to the Pro, which has been the bright spot. It's been resilient, positive comps through Q3. What do you think is driving that resilience? Is there a macro factor tied to it? Or is it company specific?

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

I think it's a combination of a couple of things. First and foremost, as I mentioned, 5 years ago, there was no real semblance of a Pro Strategy at Lowe's. So we attack what we described as retail fundamentals. We basically want to shore up the foundational parts of the Pro Strategy, and those things are very basic. Having job lot quantity in stocks, making sure you're staffed to have loading assistance, make sure you're priced right and making sure that you are doing the service level things require that the Pros will see you as a viable option.

And then we took 1 level up and we said now we need to implement a loyalty program. So we implemented our MVP Pro Rewards Program. Then we have to implement a new CRM program, which we have one of the best CRM programs in the business, and we have to improve the ability to deliver to the job site. And so because we've done all of those things, we feel like that we've created a much better Pro strategy then what was next is how do we give them the brands that they want that will resonate with them to demonstrate a commitment to their business. And so we went through the list of all those key brands that had either left Lowe's over a period of time for 1 reason or another or brands that we didn't carry. And a great example of that is getting client tools back in the Lowe's assortment, which is the #1 branded tool for electricians and HVAC professionals.

And so those things were part of our Total Home strategy related to Pro. So when you combine all of those efforts with the fact that the medium age of the housing stock is 41 years old, I think those 2 things are driving the resilience in that small to medium Pro's business and why we've been able to have consecutive positive comp quarters.

Now we know we have to earn that business, and we've committed that we can grow 2x the market, and we've done that. And we think we can continue to do that with the investments we've made and with the focus we have. And so I think it's a combination of the execution of the Total Home Strategy combined with the aging housing stock and how we continue to reach out to these customers.

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

You mentioned the backlog, which still seems healthy. It could residual from even the COVID period. How is the Pro basket changing? And how is the small- to medium-sized Pro behaving?

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

Yes. It's another good question. I would say that you're seeing these customers transition to what I would call smaller remodel repair projects versus what we may have seen maybe 3 or 4 years ago. But that's to be expected as well because of the cautious nature of the consumer. So the Pro customer, small to medium is remaining busy. Their backlog is healthy. But those project sizes are a bit smaller because they may be taken on a room versus an entire basement. It may be taking on a powder room versus a kitchen, but those customers are resilient. They remain busy. And as I said, we're pleased with the fact that we delivered another positive comp, which tells me that we're doing something right.

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

Before we pivot to DIY, we just take the Pro from when you started to what it looks like now. Service, product, technology, can you just go through what has changed and how this -- how that side of the business is operating?

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

Yes. I mean, for us, it was really foundational because what the Pro customer does for the home improvement business, it provides you with a consistent flow of customer traffic 12 months over the year because these customers have businesses to run to have employees to keep staff. And so they remain resilient because you become a supply house, so to speak, for their business.

And so that's the strategic imperative on why Pro is important in-home improvement because it just provides a more constant revenue flow irrespective of weather patterns, et cetera. And we didn't understand that because over time, what Lowe's had done, they shifted to a more private brand and merchandising strategy to chase margin rate not understanding that the Pro customer is very brand loyal. And so a lot of the brands that the Pros resonate to because of the debate over private brand versus national brand. They exited and went other places.

And so when I arrived 5 years ago with members of the management team, it would be very obvious to myself, Bill Boltz, who is our EVP of Merchandising; Joe McFarland, our EVP of Stores that we had an incredible gap from a brand standpoint, a product, but then you start to look at service levels and there was really no reason for Pro to choose Lowe's over the alternative home improvement competitor because we didn't have the brands, our staffing was very inconsistent. Our inventory levels were anemic, and we had no loyalty program to give you incentives or repeat visits and our CRM program didn't exist.

Our CRM program was if I happen to know you when you walked up, that was great but that was the extent of it. And so you could be a $1 million customer and you would treat it the same as the weekend warrior customer, which doesn't incentivize return visits. And so we have to address all of those things. And so we -- again, we started with what we call retail fundamentals that is get the inventory debt you need, make sure your price right, make sure your staff, make sure you have something as simple as parking next to the store under the canopy so that the Pro customer is not at risk of having a tool stolen in their truck and the parking lot. And those little, small things, may seem very, very trivial but to a customer whose entire living and their entire capital investment is typically in their vehicle that is a really big deal. And we didn't understand any of those things 5 years ago.

And so we addressed those foundational things first. But then we had to get to a more sophisticated level of, okay, now we've got these basic things in place. We need a loyalty program so that we incentivize customers to shop more, you shop more, you save more and you create some pattern of coming in. And so we launched our MVP Pro Rewards Program, which has been incredibly successful and exceeded all of our expectations. And when you combine it with our Lowe's credit, those customers are incredibly more valuable, shop a lot more frequently.

And then we put in a best-in-class CRM platform, it gives us the ability to not only recognize the customer but recognize what they're buying but more importantly, what they're not buying and how we can help them grow their business. And so those were the foundational things. And then the question was, okay, we can do these things now but I need a more dependable delivery mechanism to the job site. And so with a combination of expanding and improving our supply chain and the enhancements of gig delivery, we can now deliver within the hour, same day, next day on a much more consistent basis. And so all of those things are foundational.

And so we now continue to push forward and continue to enhance because what we've done is created a really good service model for the medium -- small- to medium-sized Pro. And now we're going to continue to perfect that and then we'll go to the next iteration of the strategy here in the coming months and years, we'll continue to build on that. But without those investments, we would not have had the ability to take advantage of the resiliency of this customer because of the age of housing stock and other factors. But again, our Total Home Strategy define the importance of the Pro and those things I just walked through, and now it's up to us to continue to enhance and execute those things.

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

Now back to the DIY side. You talked about this is where the pressure has been some on discretionary. What are the indicators that you can look for to see when this bottoms are looking around the corner?

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

We know -- as you can imagine, we do a lot of work to determine customer sentiment that's a big piece of it because financially, these customers have really good, what we call household balance sheets. They're in good shape, home price appreciation and personal disposable income but I think there's a degree of caution that some of these consumers have based on just the economic backdrop, what they're hearing and seeing and reading.

So far us customer sentiment is important, we can measure that. The other thing that we can measure is just what they're spending on and how frequently they're spending. And so we talk a lot about big ticket discretionary spending. To me, that's a real key indicator of the confidence of the customer and their willingness to spend on things that are not core needs. It's -- we do a really good job of replacement and repair. And what do I mean by that? If your roof is leaking, we can replace it or repair it. If your water heater stops working, we can replace that.

And so when you start to look at replacement and repair purchases versus discretionary purchases, I want to redo my kitchen. I want to put hardwood flooring in. I want to put in granite countertops, et cetera, that's when we start to see the change in consumer behavior for the DIY customer that indicates that things are opening back up again. So it's on frequency of shopping, so units is on transaction size and is on the specific categories in the store that they're buying. And those categories that will give us confidence that the consumer is being less cautious when we start to see more purchases in those, what we call discretionary categories that are more decor-related inside the home. When we see that, then it gives us a positive indication that the consumers' confidence is being rebuilt and they're starting to come back like we hopefully will see here at some point in the future.

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

You mentioned in last quarter, appliances and flooring, and we talked about how units were pressured but we were seeing average pricing from vendors come in a little bit, that's a little bit scary when we see that if there is, let's say, disinflation, deflation. How do we think about those 2 dynamics working together?

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

For us, we don't anticipate that we're going to see any cost increases coming in from our supplier base in the near term, we don't believe that we'll have any material impact to our business from an inflation or deflation perspective. Like every other retailer in the world, we're working to get cost out, and we're trying to claw back costs from some of the cost increases that have been incurred over the past couple of years.

My use in retail has taught me something very basic. If you has the best data has the best chance to get cost out from suppliers. And 5 years ago, our data was not existent and our suppliers knew it. We had no analytics. We had no focus on it. It was more of an emotional discussion. Now we have a pricing analytics team that has robust data. We have component costs, raw material costs, we have a really good view of what everything costs. So we know if a cost increase is legitimate. And we also know when a cost decrease is relevant and deserved. And so we're having those conversations as we speak with all of our key suppliers, and that is an ongoing effort. And as we continue to work through that, we will pass some of those benefits to the consumer to ensure that we continue to offer competitive prices, and we'll continue also to drive productivity as well.

So it's a combination of all those things. But the key message is we see no material impact from inflation and deflation in the near term for the home -- for our business. And we're very fortunate that the home improvement space in general remains very rational from a pricing and from a promotional standpoint. So we don't see any competitor doing anything that is uniquely different that's going to drive some unique promotional environment that we don't anticipate.

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

So a neutral inflationary or cost backdrop, how the basket evolve, that's up to the customer still.

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

Yes.

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

Fair enough. Elasticity, are there any signs of as pricing is coming in, the units are coming up? And does it behave differently across categories?

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

It's too early to say that. I mean, historically and typically that's what you would see. And that's what we hope to see, but it's too early. What I will tell you is that consumers now are looking for value. And that's one of the reasons why, as I mentioned earlier about Black Friday and our appliance performance, it was really driven by the fact that we had the best value in the entire year for that category. And I think if you can offer the consumer a value and if you can offer that value in a way that it drives the right level of profitability internally then that's going to be the winning solution.

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

Back to potential savings that you get from suppliers and/or suppliers taking price down because maybe their input costs, can you summarize how that -- what the situation looks like broadly and then how you will handle potential price decreases as you see them?

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

It depends on the category and it depends on the competitive set. And I mean those are all the inputs that will determine what we do with pricing. Obviously, as I mentioned earlier, we're aggressively working with the suppliers where we've taken cost increases over the past couple of years to get the cost increases down if the data tells us that we have a valid reason for those costs to come down. And so that -- those are ongoing efforts and ongoing conversations, but as I mentioned earlier, we're in a much better position today than we've ever been because of the analytics, because of the systems, because of the core team that focuses on this 7 days a week, and this is all they do, and we've had success in being able to drive incredible value from their work.

But as we get that cost out, we'll determine how we input those costs out based on the broad array of environment of the competitive set. If we want to lead on price, if we think that will be beneficial from an overall profitability standpoint, it's a combination of all of those things.

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

I'm going to get to margin in a minute. But since you're here, which is a treat, I want to ask about the broader repositioning of the company. You gave me this analogy maybe when you started at the elephant and the rope for the chain, how to change the culture and it may be difficult. So just talk about where you are in the broader transformation repositioning and what still needs to be done to drive the productivity and the margin?

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

Well, I think with any company as large as Lowe's and then we have well over 300,000 employees that we call associates, one of the toughest thing to do is to change the culture because a lot of executives believe that if you change the culture in your corporate office and if the corporate office feels good, then the culture feels good but that has nothing to do with the culture of a retailer. The culture of a retailer is specifically the men and women that work in the stores and engage with the customers. I mean that is the culture of the company. I can give this room, the most impressive set of slides and data and graphics that you've ever seen. But if you go to a store, tomorrow and have a bad experience, it's all for not.

Well, if you log on to Lowes.com, it's a clunky experience than it was all for not. So the culture has to permeate at the front end of the business and that's in our stores, and that's the experience our customers have. And so that's been to work. And part of what we've had to do is focus on that. I mean we established what we call Lowe's University, and we literally have brought in every single store manager in the company for 1 week of cultural training over the course of the last 3 years.

It's important for every manager to understand what we are committed to as a company and not only what we're committed to but how we're going to go about doing that. What it takes to be successful? And when we talk about the core behaviors of our leaders, what does that really mean? And again, you can send out a memo, you can do a video but it's nothing more powerful then bringing those men and women into a 1 location, 50 at a time and have them to meet with members of the executive team and hear directly from them, which means that every week, part of my job is to go down and to spend time with that team.

So I spend time with those store managers and they hear directly from me about expectations on the culture and expectations on the core behaviors. That's where the culture starts. That's where the cultural change starts. But then it only evolves if what I'm saying and what's being said by the leadership team actually occurs in the actions we take and the decisions we take. The past, we can talk all day long about how we care about our associates and how we're committed. But when you can spend $3 billion like we have over the -- since 2018 on wages and benefits just for frontline associates and employees, that's a more direct message. That's putting your money where your mouth is, as an example. And we're committed between now and 2025, spending another $1 billion. This year alone, we're going to spend over $350 million on wage and benefits, and that's all built into our financial plan. But to me, that's part of the culture because the culture of any company is, are you taking care of your associate base and do they feel like they matter? And so it starts there. And then from that, you have to reward people who make decisions and take prudent risk.

The example I gave you, the [analysis] that we had, people afraid to make decisions because they didn't want to get in trouble. And so we just put a philosophy in place that if you think first about the customer and first about your fellow associate, then those are decisions that you empower to make. And luckily for me, every associate in the company has my e-mail address and trust me, they use it because I hear from them every week about something, which is good because that tells me that they're passionate about their jobs, which means that I got to be passionate about making sure that we get back to them on a concern that they have.

And so it's one of the many ways that we try to drive culture. I'm leaving here today headed to a store to do a town hall with a group of all the associates, that's what I do every week. It's not because it's a way for me to demonstrate how great I am as the CEO is because I'm trying to stay informed, and the best way for me to stay informed is I'll sit in the board room and listen to my executives, give me information (inaudible) for me to get that information, but to go out and validate it by standing in the aisle, talking to customers and engaging with the associates that's actually doing the work.

And so part of that is a cultural transformation. Is it easy? No. Is it ever done? No. But we've made tons of progress, and that progress is reflected in the financial results for Lowe's today versus 5 years ago. And we -- and the good news is we still got a lot of work to do. And so we've got a lot of upside potential that we have yet to realize but we feel like the foundation is in place, and we will get there.

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

Thanks for that. Easing into margin, I want to talk about shrink, which Lowe's seems to have been industry leading, maybe retail leading and how you've dealt with it. So talk about how you've done it to shrink normalize for the industry, meaning it's now that there's so much action it should only get a little bit better.

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

Well, I think one of the first things that we did is we invested in technology early on to address shrink. Before it became a -- what I call a retail phenomenon of organized retail crime, we were focused on this 5 years ago of putting in the most sophisticated technology in retail across all of our stores. Not to mention, we have one of the best teams in our department, we call asset protection and operations as managing this on a real-time basis. And so we're pleased with our performance vis-a-vis the industry and retail in general.

I will also say that we have some benefit because our store footprint puts us in more rural and remote areas away from urban settings. I think where, obviously, you're going to have a greater negative impact to shrink-related issues and organized retail crime in urban areas. I think it's a combination of geographic footprint, investments in IT and good old-fashioned customer service and training that this paid a lot of dividends for us. And we've been incredibly pleased with our results not only last year and this year, but just over the last 5 years, and we hope and believe that the investments we put in place with allow those results to sustain.

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

Maybe close with this question around margins, long-term margin target, some degree of sales leverage, [it will] happen when it happens. OpEx productivity and PPI, can those -- the latter 2, could those happen in any backdrop for sales? And then can we make progress towards that margin over time?

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

Well, what I would say is we're still committed to our long-term operating margin targets. Obviously, with the pullback in discretionary DIY spending is giving us a little bit of a more elongated pathway to get there. But you said it, if we can get the top line, everything else is working better than what we anticipated when we start to build all these processes in place. We feel great about our supply chain transformation, all of our IT investments have given us the ability to have the productivity you discuss. Case in point, we delivered a 7.4% negative comp in the third quarter, and we grew operating margin, and we grew operating margin and we had improvements in customer service in both DIY and Pro customers. And that's primarily because we put in a best-in-class labor management system that allows us through machine learning and activity-based inputs to drive predictability of labor staffing by store by day, by department.

And so it gives us the ability to more easily flex up and down based on revenue that's coming into the store without destroying customer service. Because anytime you can leverage payroll, leverage operating margin in a negative comp environment and deliver 200 basis points of customer service improvement in the DIY and 300 in the Pro, it tells you that something is working.

And so we feel good about all those inputs but it comes down to the top line. When we start to see that DIY customer come back with the investments we made in our PPI, perpetual productivity improvement initiatives and how that has become not a buzzword but a cultural execution expectation across operations, merchandising, supply chain, IT, et cetera, then we feel like that we'll be able to achieve those long-term targets.

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

Maybe I'll close with 1 more.

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

Sure.

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

Does capital allocation have the buckets? Or are your priorities changed at all between repurchase, paid debt, et cetera?

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

No. We are -- we remain committed to our capital allocation priorities of having roughly $2 billion in CapEx on an annual basis, having a dividend payout ratio of 35% and then taking all remaining cash proceeds and giving it back to the shareholders via share buyback. So that best-in-class capital allocation philosophy and focus remains unchanged. And we're committed to it.

One of the many things that I'm pleased with, with the execution of the Lowe's team is the fact that we've been able to deliver dramatic improvements in our return on invested capital. I mean, to be as large as we are, to have an ROIC number over 30% from where we came from is a huge testament to the discipline around capital allocation and a commitment to doing it the right way and doing it in a very sustainable way. And we have every expectation to maintain that.

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

Appreciate it. Thank you for all your insight. Good luck in Q4, and best of luck going forward.

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

Thank you. Happy holidays.

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

Appreciate it.
