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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good morning, everyone. Welcome to Lowe's Companies Fourth Quarter 2023 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 of IR*

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, everyone. In the fourth quarter, comparable sales declined 6.2% as DIY customers continue to remain cautious with their home improvement spend and harsh weather impacted large parts of the U.S. in January. In spite of these challenges, I'm very pleased with the excellent customer service in our stores and strong operating profit performance for the quarter, driven by a disciplined focus on our perpetual productivity improvement initiatives or PPI.

Looking at the full fiscal year 2023, we delivered sales of \$86.4 billion, adjusted operating margin of 13.3% and adjusted earnings per share of \$13.09.

Beginning with our DIY sales results. November and December trends improved from the third quarter, followed by a sharp drop in traffic during periods of extreme weather in January. Macroeconomic factors like persistent inflation and a stagnant housing market continue to make DIY customers and consumers hesitant to spend on big ticket purchases for their homes. And those who did engage in home improvement activities took on smaller, nondiscretionary projects with a heightened focus on value. This impacted demand for bigger ticket interior categories like kitchen and bath, flooring and appliances.

In last quarter, we shifted our strategy to adapt to these changing consumer behaviors resulting in a record Black Friday and Cyber Monday online sales and improved holiday sell-through and margins. While we're pleased to see these results, we're now focused on winning spring and we're excited to see how the customer responds to our more targeted traffic-driving marketing strategy and our lineup of great spring products at an outstanding value. Bill will provide more detail on our compelling product assortment for spring later in the call.

Amongst the most exciting changes for this spring is our new DIY loyalty program that we announced in January. This first-of-its-kind rewards program designed for DIY customers gives these value-focused homeowners more reasons to choose Lowe's. In a marketplace where nearly all DIY home improvement customers shop multiple retailers, MyLowe's Rewards loyalty program is designed to get these DIY customers to choose Lowe's over other retail competitors for the home improvement needs. We expect this to drive traffic and return visits while also enabling us to personalize offers and experiences for our loyalty members, creating a flywheel effect that increases DIY loyalty and demand over time, both in-store and online. MyLowe's Rewards will be available nationwide in March just in time for spring making Lowe's the only national home improvement retailer with a distinct loyalty offering for both Pro and DIY customers.

Now moving to Pro. Despite a challenging macro environment, and difficult weather in January, our comparable Pro sales were flat for the quarter. As a reminder, our core Pro customer is a small- to medium-sized business owner. And in our recent Pro survey, these customers told us their backlogs are in line with last year, and they are cautiously optimistic about their ability to generate and close leads in 2024. We remain focused on executing our holistic Pro strategy with more convenient fulfillment options and enhanced product assortment, creating a best-in-class digital experience and a rewards program that incentivizes long-term loyalty. As these investments scale and mature, they will increasingly save Pros time and money, enabling us to earn more of their business as we aim to grow Pro at 2x the market rate.

Now turning to online. Comparable sales were flat for the quarter, and we're pleased to see higher conversion rates and lower returns, a positive indicator that customers are responding to our faster fulfillment and improved digital experience. Our talented technology team remains focused on developing a best-in-class omnichannel experience to seamlessly serve our multigenerational customer base. Including co-creating innovative customer solutions with world-class technology companies like our immersive kitchen design app for Apple's new Vision Pro headset and using generative AI to improve how we sell, shop and work like our home improvement ChatGPT plug-in.

Now let's transition to our view to macro. As we look forward, many of you are asking when we expect home improvement demand to inflect? Although it's a very fair question, unfortunately, it's still very difficult to predict. And while there is increased confidence of a soft landing, there's still a lot of speculation on the timing of anticipated interest rate cuts in the pace of slowing inflation. It's also unclear how quickly the consumer will react to these changes and how quickly their spending habits will change. Overall, the consumer is financially healthy. But in this post-pandemic time frame, customers are still showing a preference of spending on services with elevated demand for travel, restaurants and other experiences. And while we anticipate these trends will normalize, the timing is uncertain.

Also, existing home sales are at levels we've not seen in almost 30 years. And even as mortgage rates decline, 2/3 of homeowners remain locked in at rates below 4%, which may keep many on the sidelines. Due to these factors, we expect DIY demand to remain under pressure, and Brandon will provide more detail on our 2024 expectations later in the call. However, we're very confident in our strategic plan and in our ability to execute at a high level in a multitude of economic environments.

Despite near-term uncertainty, let me remind you why we remain bullish on the medium- to long-term outlook for home improvement. The 3 core demand drivers of our business, disposable personal income, home price appreciation and the age of housing stock remain supportive. When you

pair these factors with trends like chronic undersupply of homes, millennial household formation, baby boomers aging in place and a sustained number of people working from home, you can see why we are confident that home improvement demand will trend upwards over time across both homeowners and Pros. And in the meantime, we're focused on controlling what we control, and making the right investments in our Total Home strategy to modernize our supply chain and IT infrastructure, localize and improve our merchandising assortments, rolling out a Pro and DIY loyalty program, continuing to elevate our store environment and developing a best-in-class digital and omnichannel experience. All of these investments in our Total Home strategy will position Lowe's to win in the short run and set us up for strong sales and profit growth when the home improvement market recovers.

Before I close, I'd like to extend my appreciation to our hard-working associates for their commitment to serving customers. In recognition of their dedication, we awarded our frontline associates with an end-of-year discretionary bonus of \$140 million. This is our way of saying thank you to hourly associates and assistant managers who serve our customers and make our communities better. As I travel across the country visiting stores and conducting town halls to hear directly from our frontline associates, I'm consistently humbled by their passion, commitment and their expertise.

Now I'll turn the call over to Bill.

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

Thanks, Marvin, and good morning, everyone. While softer DIY demand trends continued this quarter, we remain focused on highlighting value and convenience, both in our stores and online to a price-conscious consumer, all while maintaining a balanced focus on profitability. We are also staying committed to serving a resilient Pro, which resulted in flat Pro comps as we continue to enhance our Pro product and service offering.

Beginning with building products. This was our best performing area with positive comps in Building Materials. This strength was fueled by an increased demand for roofing and drywall, combined with improved fulfillment capabilities and in-stock positions to better serve our Pro customers. Throughout the quarter, we continued to launch additional Klein products across our stores, bringing the #1 tool brand for electrical and HVAC professionals back to Lowe's. We now have the largest assortment of Klein tools in the home improvement retail channel with initial sales exceeding our expectations across electrical, hand tools and stackable tool storage. Throughout the store, we continue to introduce new and innovative products to Lowe's, like Pella's hidden screen windows. This new window includes a built-in screen that appears when the window is open, but hides away when it's closed.

Turning to home decor. This division was significantly impacted by softer DIY demand in bigger ticket interior categories like kitchens and bath, flooring and appliances. This past quarter, we pivoted our go-to-market strategy to be more responsive to a shift in shopping trends, like the appliance consumers' increasing preference for a single unit purchase and their search for the best deal. While these actions pressured our average selling price as expected, this approach was a major contributor to our successful Black Friday and Cyber Monday events.

And while some consumers remain budget conscious, we are seeing others trade up for innovation, which we continue to offer across all major appliance categories. A great example is our exclusive LG smart refrigerator, which has a double freezer and also makes the popular slow melting craft ice. This product is consistently a top seller despite retailing for over \$2,500. This type of innovation adds to our already industry-leading assortment in appliances, including high-quality brands like Bosch, Miele, LG, Samsung and KitchenAid, and we are continuing to help our customers see the value and attainability of trading up for affordable premium features.

Paint is another category where we've seen product innovation resonate like our exclusive line of Spec Right paint designed for Pros who paint. Beyond gaining traction with Pros, we saw strong exterior paint demand before the weather turned colder in January. which gives us confidence we have the right offering in place as spring arrives. We also recently completed the rollout of our upgraded paint department, which converted our color wall to trusted Sherwin-William colors and improve the shopping experience to make it easier for our customers to grab the higher-margin attachment items they need to complete their paint projects.

Turning to our results in Hardlines. This is another area where we quickly adjusted to the changing consumer buying patterns, which was reflected in our improved holiday sell-through and profitability. We are also encouraged that our new rural assortments continue to resonate across the country with strength in apparel, pet and automotive as consumers respond to the products and brands. We also recently launched a new partnership

with Sunrun, the market leader in home solar and battery installation. This partnership now enhances our services offering for consumers looking to power their homes with renewable energy.

Lowe's is the go-to destination for homeowners in spring. And as we enter our biggest season of the year, we are positioning ourselves to capitalize on this demand. As Marvin mentioned, we are excited about our product lineup. The launch of TORO builds on our industry-leading outdoor power equipment lineup alongside John Deere, Ariens, EGO, CRAFTSMAN, Husqvarna, Kobalt and SKIL, our outdoor power equipment assortment is unmatched in home improvement, which is reflected in our continued market leadership in this space. I'm also excited about our new patio sets from our private brands, Allen + Roth and Origin 21, which enables homeowners to update their outdoor spaces for spring with trending styles across multiple price points. And if consumers don't see the color they're looking for on our sales floor, they can easily shop the extended aisle with associates now able to tender the purchase directly on their mobile smart devices. The merchants in our seasonal businesses are also bringing customers innovation and functionality at more competitive prices like our new exclusive Char-Broil grill lineup, which lets grillers switch from a traditional grill to a griddle in seconds or the fast-growing Blackstone brand of grills that continues to bring new features and value to the market.

Beyond our compelling seasonal assortment and strong in-stock position, I'm also looking forward to launching our enhanced marketing strategy for spring. This season, we are taking a more sophisticated tech-enabled advertising approach and we will be featuring traffic-driving events that will motivate homeowners to get started on their spring projects at Lowe's.

We are also leaning into live sports with an expanded NFL relationship and leveraging our popular commercials featuring Lowe's Home team players trying their hands at DIY projects. We are extremely pleased with the success of this season's home team players with 2 members of the Lowe's team, Travis Kelce and Christian McCaffrey, both participating in Super Bowl 58 while being featured in our commercials.

Shifting gears to merchandising productivity. Our team is making tremendous progress on our perpetual productivity improvement or PPI initiatives, which, as we planned, are offsetting the cost of our supply chain and Pro investments. As a reminder, the PPI initiatives that I outlined at our analyst and investor conference include expanding our private brand penetration, improving inventory productivity, maintaining a disciplined approach to pricing and promotions, scaling our retail media network and closely managing product costs.

Over the past year, we have been working closely with our vendor partners to claw back some of the cost increases we absorbed during periods of exceptionally high inflation. And now that raw material and transportation costs are normalizing. Our best-in-class cost optimization tool gives us robust data down to the item level that allows us to take a calculated surgical approach, helping guide us to reducing costs across our portfolio. As we work to recoup these costs with our suppliers, we are reinvesting those savings into our marketing and merchandising strategies to drive traffic and sales.

As I close, I'd like to thank our vendors and merchants for their unwavering focus on delivering value to our shared customers and for putting us in a strong position to win spring.

I'll now turn the call over to Joe.

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

Thank you, Bill, and good morning, everyone. I would like to start by thanking our frontline team for their relentless focus and execution this quarter. Their efforts to serve our customers while tightly managing controllable expenses once again resulted in improved customer service scores and strong operating profit performance despite slower sales. Customer satisfaction scores were up 200 basis points this quarter versus last year with improvements in both Pro and DIY, reflecting the hard work of our frontline associates combined with improved omnichannel fulfillment capabilities. In fact, this year omni scores has improved almost 25% since 2020. Customers have new functionality like 2-way texting, where they can be notified in advance to confirm their delivery date as well as same-day delivery options through our gig network. They can also use our new self-service functionality to track their order status and resolve issues directly, all without needing to call a store.

In addition to expanding our fulfillment options and improving how we communicate with our customers, we're also enhancing the BOPIS or buy online, pickup in store experience through our new front-end configuration. We completed over 450 front-end rollouts this year with over 500

planned for 2024. Customers are embracing the new front-end experience, telling us they appreciate the faster and easier checkout process. This new front-end configuration also keeps sales associates in the aisles helping customers instead of needing to assist with checkout process when lines get long.

While we are improving the front end of our stores, we are also making strides on the back end with our ongoing freight flow transformation. We are further improving our freight flow process with distribution centers now adding new labels that are linked to each store's layout. These labels provide our store teams a direction of exactly where to place the product on the sales floor once the freight is removed from receiving. These enhancements will make it quicker and easier for associates to get products onto the floor and cross merchandise attachments and will drive better in-stocks for our customers and improve payroll productivity for our stores. These new capabilities and improved processes are all part of our ongoing perpetual productivity improvement or PPI initiatives, which both improve the customer experience and drive profitability.

Turning to our efforts to become the employer of choice in retail. I am really pleased with the progress we've made. Last quarter, we saw a record response rate to our annual associate engagement survey with 90%-plus participation. And even more importantly, scores improved significantly across 3 areas that we measure; engagement, leadership effectiveness and inclusion. It's clear that better associate engagement leads to lower turnover and directly translates into better business results with a workforce more focused on serving our customers and driving productivity in our operations.

As Marvin mentioned, we announced \$140 million in discretionary bonuses this quarter. This includes an incremental \$5,000 for our assistant store managers and other frontline supervisors as well as our special discretionary bonus of \$400 for full-time hourly associates and \$200 for part-time hourly associates. Additionally, since 2018, we have invested over \$3.5 billion in incremental wage and share-based compensation for our frontline associates. In fact, we are one of the few retailers to award stock grants to our store managers and assistant store managers so they share in our long-term success. These programs for our store leaders are not new. In fact, store managers have been receiving share-based compensation for decades and assistant store managers since 2019. We are also creating opportunities for advancement for our associates to encourage them to build their careers with Lowe's.

Since 2018, we have added over 10,000 new department supervisors and over 2,500 new assistant store managers. And through Lowe's University, we are training and developing our associates for their next role. This year, we're extending our advanced leadership training to our assistant store managers to equip them with the tools they need to succeed as they move up in their career. With these enhancements, we've worked to increase the number of store managers promoted from ASM to over 80% over the past 3 years. In fact, more than 80% of our leadership roles are now built from within.

All of these investments have led to one of the best spring staffing levels in many years, and the stores are ready to serve our customers this spring. We are very excited about the new MyLowe's Rewards DIY loyalty program and the great spring merchandise lineup Bill outlined. As I close, I would like to once again thank all of our store associates for their hard work and dedication.

Now I'll turn it over to Brandon.

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

Thank you, Joe. Let me begin with our Q4 results. We generated diluted earnings per share of \$1.77. As a reminder, in the prior year, we recognized \$441 million of pretax transaction costs associated with the sale of the Canadian retail business. My comments from this point forward will include comparisons to certain non-GAAP measures from last year where applicable. Q4 sales were \$18.6 billion.

Of note, prior year sales included \$958 million generated in our Canadian retail business and approximately \$1.4 billion related to the additional 53rd week. Also, Q4 results reflect approximately \$200 million in sales headwind due to the related shift in our fiscal calendar. Comp sales were down 6.2%, driven by continued pressure in DIY bigger ticket spending and unfavorable January winter weather. Lumber deflation did not have a material impact on comp sales. Although the calendar shift pressured total sales growth in Q4, it had no impact on comparable sales as comps are calculated based on weeks 41 to 53 in fiscal 2022.

Comparable average ticket was down 0.1% to prior year. Continued ticket growth in many Pro-heavy categories offset appliance pricing pressure and lower DIY bigger ticket sales. Comp transactions declined 6.1%, driven by the DIY slowdown in unfavorable January winter weather impacting traffic. Our monthly comps were down 4.8% in November and 6.6% in December. January comps declined 7.4% as we experienced significant pressure during weeks of unfavorable winter weather.

Gross margin was 32.4% of sales in the fourth quarter, up 7 basis points from last year. Gross margin benefited from multiple PPI initiatives as well as favorable product mix and lower transportation costs. These benefits were somewhat offset by supply chain expansion costs. SG&A of 20.9% of sales delevered 5 basis points versus prior year adjusted SG&A as the momentum we continue to build with our PPI initiatives across all functional areas of the company largely offset sales volume deleverage.

Operating margin rate of 9.1% declined 48 basis points versus prior year adjusted operating margin. The effective tax rate was 23.8%, in line with prior year adjusted effective tax rate. Inventory ended the quarter at \$16.9 billion, \$1.6 billion lower than the prior year quarter as we invest in high-velocity Pro SKUs while managing replenishment in line with sales trends and improving the flow of spring product builds through our supply chain. As a reminder, prior year inventory excluded Canadian operations as the sale was complete before year-end.

Now turning to capital allocation. In 2023, we generated \$6.2 billion in free cash flow and returned \$8.9 billion to our shareholders through a combination of share repurchases and dividends. During the fourth quarter, we paid \$632 million in dividends at \$1.10 per share and repurchased 1.9 million shares for \$404 million returning over \$1 billion to our shareholders. Capital expenditures totaled \$620 million in Q4 as we continue to invest in strategic initiatives to drive growth and profitability. Adjusted debt-to-EBITDAR finished the year at 2.81x. And lastly, we delivered a return on invested capital above 36% for the year.

Now I would like to discuss our 2024 outlook. As Marvin mentioned, we are bullish on the medium- to long-term outlook for the home improvement industry, but the near-term macro backdrop remains uncertain. There is optimism around potential interest rate cuts and improved consumer sentiment. However, the timing of Fed actions remains unclear, and there can be a lag before monetary policy impacts the consumer. Also housing turnover remains depressed and the consumer is still showing a greater preference for spending on services rather than goods.

We are expecting these factors to continue to pressure home improvement spending in 2024, especially for the DIY. And with that in mind, we are expecting sales ranging from \$84 billion to \$85 billion and comparable sales declines in a range of 2% to 3%. Pro sales should continue to outpace DIY as we leverage our multiyear strategy to improve product offerings, fulfillment options in the in-store and digital shopping experience to drive Pro growth at 2x the market rate. We expect operating margin in the range of 12.6% to 12.7%.

When we bridge our 2023 operating margin to our 2024 expectations, there are a couple of points to keep in mind. First, the impact of sales volume deleverage and second, the cycling of a favorable legal settlement in each of the first 2 quarters. These pressures are partly offset by the expected positive impact of our ongoing enterprise-wide PPI initiatives. We have made significant progress in realizing our productivity goals over the past few years, and we remain laser-focused on driving these PPI efforts and closely managing expenses through this tough sales environment. These expectations result in full year earnings per share of approximately \$12.00 to \$12.30.

Now to assist you with your modeling I'd like to take a moment and provide some color on the cadence of our expected results for the year. As a reminder, the steep pullback in DIY demand, which intensified in the third quarter of 2023 sets us up for different compares in the first and second half of this year. Given this, we expect first half comp sales to remain under pressure as the current DIY demand trends continue. But as we move into the second half, we expect comp sales to improve as we begin to cycle over the pullback in the third quarter.

To be clear, we are not forecasting an improvement in demand trends this year. Rather, the compares are easier in the second half. And while we are planning for a normal spring season, the timing of spring is unpredictable and always brings some variability to our first half performance. Given our customer mix, these DIY drivers disproportionately impact our business. Now more specific to our first quarter, we expect comp sales to be consistent with our fourth quarter results approximately 300 basis points below the bottom of our full year guide. The combination of lower sales volumes as well as cycling a sizable legal settlement is expected to result in a Q1 operating margin rate approximately 200 basis points below the prior year adjusted rate.

Before I close, let me remind you of our capital allocation strategy, which remains unchanged. Our first priority is to reinvest in the business with capital expenditures of approximately \$2 billion. Next, we continue to target a 35% dividend payout ratio. We also plan to use our free cash flow to repay a \$450 million bond maturity and then return excess cash to shareholders through share repurchases.

In closing, we are confident in our ability to execute through the near-term market uncertainty and remain focused on realizing the benefits of our total home strategy while continuing to drive sustainable shareholder value. And with that, we'll open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today comes from the line of Peter Benedict with Baird.

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

First one would be just around the sensitivity of your margin forecast, if comps end up trending below that 2% to 3% range for the year, and then alternatively, as you think perhaps longer term, as comps swing positive, just what types of incrementals do you think you could achieve on that, given that you've been pretty lean on the expense front here given the current environment. That's my first question.

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

Peter, sure, this is Brandon. In terms of incremental decremental, we've established essentially a flow-through rule of thumb. If our sales do exceed the top end of our guide, we do expect about 10 basis points for every 1% of incremental comp sales on the high side. And then on the low side, sales fall below the bottom end. We're looking at about 15 basis points of margin contraction for every point of comp decline. So high level, that's more of a rule of thumb on an annual basis. It doesn't necessarily work in terms of quarterly performance.

And the other thing I'll stress is the plus 10 and minus 15, not necessarily natural output. So I would tell you that the model and the algorithm very contingent on us continuing to drive PPI across all functions, and that's what's contemplated on both the upside and the downside.

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

Okay. That's helpful. And then secondly, just around -- I mean, you've had success with your cost optimization efforts. Just kind of your view on where you stand with those, how much more is left to go? And how that kind of plays into maybe your view of average ticket versus traffic in '24. Do you think you can hold on to the ticket in '24, given all the dynamics out there and you're clawing back some costs? Do you think you'll reinvest and maybe tickets down. Just curious how you see that interplaying in '24?

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

Yes. Peter, I think to your first question on just our ability to manage costs. We're really pleased with our ability to manage expenses here in the last couple of years through this downturn. We have a robust and evolving road map of PPI initiatives. We were down comps 4.7% this year, expecting down at the midpoint, 2.5%. So our ability to manage the sales deleverage there with that robust pipeline. Again, really pleased there. And as we look out, a number of initiatives you heard from Joe and Bill that we continue to be excited about. We believe in '24 in particular, that PPI is going to enable us to offset over \$400 million of wage pressure, inflationary pressure and strategic investments.

I think the second part of your question, just as we think about ticket into 2024, we are expecting that to hold up, and that's largely what we saw in 2023. The pullback is expected again in transactions. And really, the drivers of that Pro growth positively impacting average ticket more from a mix standpoint.

And then on the pressure point side, we're continuing to see the DIY bigger ticket pressure, and that's going to continue to be a drag. We don't expect any significant improvement off of that second half 2023 run rate. And then on appliances, specifically, ASP pressure is expected to continue as we return to more of a pre-pandemic environment. But overall, as we cycle into the second half of the year, we are expecting a more normal historical relationship between average ticket and transactions.

Operator

Our next question is from the line of Zack Fadem with Wells Fargo.

Zachary Robert Fadem - Wells Fargo Securities, LLC, Research Division - Senior Analyst

I know there's a lot of moving pieces on the SG&A line as you lap the legal settlement and some of the incentive comp dynamics. So is there any way you could bridge all the puts and takes in a little bit more detail from the 13.3% operating margin in '23 to your 12.6%, 12.7% in '24? And also, any color on gross margin versus SG&A?

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

Zack, this is Brandon. I would say on SG&A, it's really 2 themes and it's the cycling of the settlements and its deleverage on lower sales. And when you look at the midpoint of the range, a step back about 65 basis points, it breaks down about half and half there. So those are really as we look at managing SG&A in '24. Those are the pressure points.

You mentioned incentive compensation. We paid a discretionary bonus in Q4 of \$140 million, which offset any previously expected Q4 benefit that we had from lower management incentive comp, and we're pleased that we were able to reward our frontline associates. But what that resulted in for the full year '23, we had the benefit from lower management incentive comp based on performance. That was offset by the discretionary frontline bonuses that we paid in Q2 and Q4. So that really does not create a headwind for us as we bridge '23 to '24. So back to the 2 themes, it's mainly the cycling of the legal settlements and the deleverage on lower sales.

Zachary Robert Fadem - Wells Fargo Securities, LLC, Research Division - Senior Analyst

Got you. And then 2 more quick ones. Just any color on gross margin. And then second, your Pro comps were slightly positive in '23 by my math and outcomping DIY for a few years now. So curious if you could just talk about DIY versus Pro mix today and if it's still in that 75%, 25% range?

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

Yes, Zack. Sorry, I forgot your gross margin question. So I'll take that one. I'll toss it to Marvin for Pro. So we're expecting gross margins for '24 to be roughly flat. And the gross margin themes are really similar to what we saw here in 2023. Ongoing supply chain investment pressure as we wrap the rollout of market delivery. We're continuing to make investments in Pro fulfillment, but those pressures are being offset by ongoing PPI initiatives that Bill discussed as we manage product costs, lower transportation, continue to expect private brands. So those are the puts and takes from a gross margin standpoint. And on Pro, I'll toss it to you, Marvin.

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

Yes. So on the mix, that's directionally correct on the percentages. And look, we feel good about the resilience of our Pro customer. And as a reminder, our customers are small to medium sized business owner, and we're actually pleased with the survey results where they feel confident that they can build, the backlog is consistent with what they saw last year and that they can continue to drive their business.

And again, they're cautiously optimistic based on what they know, but that gives us confidence that the things we're doing around loyalty, around product assortment expansion, around service levels, our digital platform and how we've dramatically improved that. And we think we have a best-in-class experience is resonating. And relative to the DIY, I mean we equally feel good about the level of execution in that business. I mean we view it as probably as a macro issue versus a strategic issue or any type of an execution issue.

As Brandon I both said in our prepared comments, when we think about the medium to long term, we're very bullish because we've made tremendous investments in this business across supply chain, IT infrastructure, omnichannel, localization, assortment planning, space productivity, store environment and service levels that we know are going to pay dividends, not only in the short run while we deal with this macroeconomic headwind, but when the market recovers, we think we're perfectly positioned to grow and take market share.

Operator

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

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

Marvin, your answer just now touched on this a bit. I wanted to put it out here. there's this perception or even misperception that the way that Lowe's expenses have been so well managed could either impact how much sales can grow and the cycle resumes or how much EPS grows if you have to put more SG&A back into the business? So I'm curious if you can comment on that.

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

No, look, it's a fair question. I think the best way for me to answer would be our customer service results. And when you look at the fact that we have improvements in both Pro and DIY 200 basis points for both. That gives you an indication that our service levels remain extremely high and also gives you an understanding of the power of our PPI initiatives because a lot of our expense takeout is not the traditional cut payroll, it is more about the investments of technology that drives productivity that allows us to add more hours to driving service and selling and taking hours out of tasking.

And Joe has talked about this for 5 years. We're trying to build a model where we invest technology and we drive productivity that allows us to have more customer-facing associates and less tasking. So we believe that our activity-based staffing model puts us in a great position that when sales go up, we invest a payroll based on the activity driven to create the sales. And when sales come down, we have an activity-based system that we think is best-in-class that we can take hours out based on department level day and hour that we think will drive the business from a productivity standpoint, but without hindering service. So we feel good about the whole model, and we don't think there's any negative implications of sales going up and SG&A not being able to be managed as tightly and as efficiently as we've managed in the last couple of years.

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

And Simeon, let me give you a quick example. If you think about 5 years ago, we had less than 50% of the stores that actually had self-checkout. And so over the last 5 years, we've mentioned we've developed our own internal self-checkout built with the home improvement customer in mind. We now have that complete across the entire chain. And now we have started our front-end transformation in adding incremental assisted self-checkouts, and we have 400 stores complete. This has also allowed us to roll out a best-in-class loyalty program for the DIY customer that is

... tied right in with our mobile technology. And so as we look to complete the incremental \$500 million in 2024. And then I mentioned in the prepared remarks, our back-end initiatives, too. So very confident in the activity-based labor model and the PPI initiatives we continue to focus on.

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

One last point. I mean that's just one example of many initiatives that Brandon and I both have on our time line that we've yet to develop and yet to implement. So this is an ongoing process that is alive and well in every function including merchandising, as Bill outlined in his prepared comments.

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

The follow-up is on the cycle. I think in some models, the weakest part of the cycle would have been the second half of '23 and even the first half of '24. And maybe the market was kind of looking for light a little bit sooner. I can't tell if that was your base case as well. It seems like the market is more dependent on existing home sales. And then Marvin, you mentioned in the prepared comments that it is a big question of whether or not we get back to something normal. And I'm curious when things start up again, do we get back to normal? Or is it something that's less than normal?

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

I'll give you my perspective, Simeon, and I'll let Brandon provide any additional comments. When you think about the cadence of our comp sales for this year, as Brandon mentioned, is more indicative of year-over-year comparison versus our forecast that the market is going to improve at some point this year. We hope that it improves and we are positioning ourselves that when that happens, we think that we will have outsized top and bottom line growth. But our perspective of 2024 is that we're going to feel this DIY pressure throughout the year and we're going to perform at a high level irrespective of kind of what type of macro environment that we're dealing with.

I'll let Brandon add any additional comments.

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

Yes, I would just say, Simeon, you mentioned the base case. I mean our base case guide assumes no change in macro conditions versus what we've experienced here the last couple of quarters. It's unclear is the timing of the rate cuts, the improvements in home improvement share of wallet. Marvin mentioned housing turnover, consumer sentiment. So sort of more of the same philosophy there. And even when we start to see some green shoots there, it's going to be -- the trends are going to improve. There is an expected lag before the macro drivers we believe are going to translate into spending. So those have been the underpinnings, the assumptions that we've made here for 2024. And again, the improvement is just a function of what we're cycling in the second half versus our views on the macro and the timing of any improvement.

Operator

Our next question is from the line of Chris Horvers with JPMorgan.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

So 2 related questions, follow-up on the demand environment. First, did you see a -- do you think weather was a net headwind in the fourth quarter? Obviously, December was warmer year-over-year and that probably helped areas like outdoor paint. But then January is much colder, and you have a much more southern geography and it seemed to impact that part of the country more. So do you think weather was actually a net headwind over the quarter? Or was it more neutral when you think about the December side?

And then Brandon, you mentioned green shoots on share of wallet. Did you see anything in the holiday period that would suggest that, that share of wallet pull forward is at least starting to move past due but maybe not moving towards the more positive side?

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

Chris, let me -- I'll hit the weather things first, and it really was just a January winter -- extreme winter weather story impacted January as we sized at about 200 basis points of impact on the month. It had an outsized impact on our Pro business over those weeks. The other weather theme also just to mention is we've cycled 2 straight years of hurricane recovery with Ian and Ida, it's about 150 basis point comp impact to Q4, just cycling that. But again, that was all baked into our expectations. And in terms of just what we saw through the holiday season, I'll actually toss it over to Bill, and he can give a view on what we saw in terms of consumer behavior there.

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

Yes. Chris, I think for the holiday, we saw -- as I mentioned in my prepared remarks, we saw record holiday sales on Black Friday and Cyber Monday. We saw the consumer respond very favorably to our Trim and Tree program and saw a nice performance there. We also saw, as you mentioned, December was warmer. And so we saw those outdoor businesses perform both on the Pro side as well as on the DIY side as the consumer continued to take on outdoor projects. As we've rolled into February and get started with 2024, as we begin to start our spring program for the South and Deep South, we're starting to see some of those early signs of spring where the weather is warmer, we're starting to get started with some of those spring-related businesses. So where we've got some warm weather, we're starting to see some of those early signs of spring. So we're excited about that.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

And then my follow-up is on the appliance category. It did track below, I think, your overall comp, you mentioned ASP pressures as you're leaning to the assortment more to the value side. Do you think -- how are you looking at your performance relative to the market? I don't know if you track line or something gives you sort of unit demand performance relative to the market. But it's your largest category. And obviously, you have a leading assortment and footprint in the store. So how do you think you're performing on the share side?

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

Yes. So for the year, we saw share growth in appliances. For the quarter, we saw unit growth across nearly all the major categories. We did see average selling price pressure as we called out. For the key major events, both Black Friday and Cyber Monday, we saw a nice performance across those holiday weeks, and we're pleased with that. We did see the consumer pivot. And we met them where they wanted to go, and that was a shift from multiunit purchases to a single unit purchase as the consumer was looking for that.

We also see the consumer moving to kind of 2 spectrums. We're seeing them look for value, so looking for products in that value conscious, and we're also seeing them trade up and finding innovation, and I'll share 2 examples. They'll look for entry-level laundry, for example, and then they're not afraid to invest in, for example, the GE Profile all-in-one washer dryer combination that retails for over \$2,500 of which we could sell every single one that we can get our hands on. So those are just 2 spectrums of what's going on in that business. And it's happening across really all categories of the appliance business. So it's really 2 spectrums of what's going on.

We're continuing to see our online appliance business perform very well as that business continues to evolve, and we're continuing to build out our capabilities there to make sure that we're meeting the customer where they want to be met and those fulfillment capabilities and delivery. And as Joe talked about, with 2-way text and market delivery and getting all those capabilities rolled out so that we can fulfill the way we want to fulfill.

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

And Chris, this is Marvin. Just one last point on appliances. The work of our market delivery supply chain infrastructure is going to be significant, not only in 2024, but for years to come. I mean, we're virtually the only national player that can deliver major appliances next day and 2-day in virtually every ZIP code in the country. And that's significant in addition to having same-day capacity for customers to have emergency purchases we still have take-with inventory in virtually every store where a customer can come in and literally leave with an appliance within the hour. And so our model is difficult, if not impossible, to replicate in the brands that Bill and his team have brought to our assortment is something that we think will continue to work for us. And look, we'll work and manage through the macro environment. And I think Bill and his team have done a really nice job, and we'll continue to listen to the consumer and pivot based on where they want us to go.

Operator

Our question comes from the line of Kate McShane with Goldman Sachs.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

You mentioned big ticket still stays under pressure in DIY. And we wondered if we could try and get our arms around that a little bit more in terms of how it compares the mix of what you were seeing prepandemic in terms of smaller versus larger projects. And that also -- that question goes to the Pro as well within the backlog. It sounds like you're seeing a stable backlog. But what are you seeing in terms of percentage of mix when it comes to those big ticket versus smaller ticket?

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

Yes. Kate, this is Marvin. I'll take the first part, and I'll let Bill or Joe jump in on the second part. But if you think about the DIY consumer for a second, the consumer is healthy and we feel good about the financial wherewithal of that consumer, they're simply choosing to leverage their spend in different places. As we've discussed and is not just us, but in all the different companies that talk about consumer spending, customers are just spending more of their wallet on experiences, on travel, on concerts, on restaurants because of this whole post-COVID relationship of getting back out and getting back to normal.

And also, I don't think is a surprise for us to say that customers purchased quite a few home-related goods during the pandemic. So we're still working through that cycle. Having said that, we believe that we will work our way out of this macro environment at some point. We're not trying to call the timing on it. Our objective is to continue to invest in our business and execute at a high level. So whenever that consumer spend reverts back to normal, we're going to be in a perfect position to take advantage of it.

One of the reasons why we launched our DIY loyalty program is specifically for the DIY consumer to give them some level of rationale to choose us over someone else and to create a level of differentiation in the marketplace, both in-store and online, so that we can be a preference for the DIY consumer. And so as we think about what they're buying and where we think that big ticket is going, I think it remains to be seen, but we feel good about what we're positioning for those consumers, and we'll wait on whatever time frame occurs with them to change their spending habits.

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

Yes. Kate, I would just add that it really varies by product category. And so as I said, with appliances, you've got really 2 spectrums going. You've got the value-conscious consumer looking at low-end pricing all the way to innovation, and we meet the customer across a variety of price points. And then you have the Pro looking at their jobs, and we can meet them wherever they want to be met, whether that's on stock cabinets and having those products in our stores again across a multitude of price points that we offer in our stores and the different levels of product quality of product that we offer both online and in-store.

And as we get ready for spring, we have a lot of new product that we're excited about. And so you think about bigger ticket product like riding lawn mowers, walk behind mowers, the launch of TORO, it's bigger ticket product. We're excited about that. And those are all new. And so same thing with patio furniture, we introduced Origin 21. We introduced the Allen + Roth program. Those are bigger ticket products as she's looking to address and upgrade their outdoor spaces. So again, we want to meet her wherever she wants to be met. We want to be able to offer a variety of pricing to her based on how she wants to be met as she takes on these projects. And that's what we're trying to do, both online and in-store.

And we're excited about the readiness. We've worked really hard with our assortments that we offer both online and in-store. We've worked really hard to make sure that we've got these variations across the country so that we're localized to address those needs across the different areas and geographies of our stores, and we're ready. We're ready for mother nature to cooperate and we're ready to get going.

So with that, Rob, we have time for one more question.

Operator

The final question will be from the line of Steven Zaccone with Citi.

Steven Emanuel Zaccone - Citigroup Inc., Research Division - Senior Research Analyst

Brandon, I wanted to just circle back to the same-store sales guidance. And I was curious if you could talk a little bit more about that second half outlook in particular because it does embed a pretty big improvement on a 1-year basis and then also on a multiyear basis, from stacks perspective. So maybe just flush out a bit what's really driving the improvement? Because you could arguably say that's not conservative in one view.

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

Yes, Steve. Really, just when we look at the cadence of comps, I'm going to reaffirm my earlier comment, we expect the macro pressures, inflation, higher interest rates, low housing turnover to persist. When we looked specifically at the second half, we're cycling the easier compares as we comp over the DIY weakness that intensified in particular in Q3 of last year. And to be clear, our comp improvement in the second half is not a result of any views on the improving macro but purely are reflective of easier year-over-year comparison. So we looked at the cadence. We looked at it a lot of different ways. I would tell you on a 2-year basis, which we leaned into pretty hard 2-year ex lumber. There's a pretty consistent trajectory as we moved across the year. So we feel really comfortable with the full year the break down, the comps and the operating margin and wanted to provide the right level of transparency and visibility to that.

Steven Emanuel Zaccone - Citigroup Inc., Research Division - Senior Research Analyst

Okay. That's helpful. And then the follow-up I had is just on the rural framework. Is there anything that's new this year as you think about the opportunity? And then when you think about the store portfolio more broadly, one of your peers has shifted to opening stores, would you consider being a net opener of stores at some point in the future?

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

This is Marvin. I'll take that final part of your question. So on the new store openings, it's -- we're going to always look for what we describe as real estate voids around different parts of the country where we believe that we can get the right return on our capital for new store investment. But candidly, I mean, our focus is on space productivity. We have such incredible upside opportunities in our stores to just invest capital in our existing infrastructure and create space productivity. We think the return on invested capital is significantly greater in using our dollars for that versus opening new stores with expensive real estate, where we're struggling to get those investments to pencil. And again, we'll open a handful of stores for voids where you're going to see us spend a ton of time on driving space productivity and creating greater value from the assets that we already own. And that's going to be our key focus.

Relative to rural, we're extremely pleased with the performance of those 300-plus stores when you think about categories like pet, things like clothing and automotive, they're positive performing, outperformed the company and most other merchandising categories. And you're going to see us start to expand some of those rural categories in nonrural locations around the country. We wanted to make sure that we learned enough about the consumer demand, enough about how we serve customers well and Bill and Joe and their teams have done an exceptional job. And so you're going to hear us continue to talk about this, but it's something that we're very pleased with. And you'll start to see it show up in more places around the portfolio of our stores.

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

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

Operator

This concludes the Lowe's Fourth Quarter 2023 Earnings Call. You may now disconnect.

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