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BBY.N - Q2 2021 Best Buy Co Inc Earnings Call

EVENT DATE/TIME: AUGUST 25, 2020 / 12:00PM GMT

**OVERVIEW:**

Co. reported 2Q21 enterprise revenues of \$9.9b and non-GAAP diluted EPS of \$1.71.

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## PRESENTATION

### Operator

And ladies and gentlemen, thank you for standing by. Welcome to Best Buy's Q2 Fiscal 2021 Earnings Call. (Operator Instructions) As a reminder, this call is being recorded approximately 11:00 a.m. Eastern Time today. (Operator Instructions)

I would now like to turn the conference over to Mollie O'Brien, Vice President of Investor Relations, please go ahead.

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### Mollie O'Brien - Best Buy Co., Inc. - VP of IR

Thank you, and good morning, everyone. Joining me on the call today are Corie Barry, our CEO; Matt Bilunas, our CFO; and Mike Mohan, our President and COO. During the call today, we will be discussing both GAAP and non-GAAP financial measures. A reconciliation of these non-GAAP financial measures to the most directly comparable financial measures and an explanation of why these non-GAAP financial measures are useful can be found in this morning's earnings release, which is available on our website, [investors.bestbuy.com](https://investors.bestbuy.com).

Some of the statements we will make today are considered forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements may address the financial condition, business initiatives, growth plans, investments and expected performance of the company and are subject to risks and uncertainties that could cause actual results to differ materially from such forward-looking statements.

Please refer to the company's current earnings release and our most recent 10-K for more information on these risks and uncertainties. The company undertakes no obligation to update or revise any forward-looking statements to reflect events or circumstances that may arise after the date of this call.

I will now turn the call over to Corie.

**Corie Sue Barry** - Best Buy Co., Inc. - CEO & Director

Good morning, everyone, and thank you for joining us. Today, we are reporting strong quarterly results, and we are encouraged to see the customer demand for our products and services, and proud of the amazing execution of our teams to these unprecedented times. However, we have not lost sight of the fact that people continue to suffer and we extend our sympathy to all those who have lost someone to this virus, are sick with COVID-19 or are facing financial hardship as a result of the pandemic.

From the very start of this crisis, we have been focused on guiding the business with 2 goals in mind. First, ensuring the health and safety of our customers and employees while protecting the employee experience as much as possible; and second, making certain we come out of this moment a strong, innovative company.

The results we are reporting today would not be possible without the effort and energy of our frontline employees working in our stores, supply chain facilities and customers' homes. I want to thank all our employees for their tremendous commitment to our customers and for living our purpose to enrich lives through technology. They are navigating not only the impacts of the pandemic, but also fires, hurricanes and civil unrest. Their willingness, even enthusiasm, to continually adapt as we manage through the evolving environment has been extraordinary.

For our second quarter, we are reporting revenue of \$9.9 billion, which is growth of approximately 4% from the second quarter of last year. Our Q2 non-GAAP earnings per share were \$1.71 compared to \$1.08 last year. Enterprise comparable sales growth was 5.8% despite the fact that our stores were open by appointment only for the first 6 weeks of the quarter. Products that help people work, learn, connect and cook at home, like computing, appliances and tablets, were the biggest drivers of our sales growth.

Trends across most categories improved materially throughout the quarter as we opened our stores for shopping, especially categories like large appliances and home theater that benefit from more experiential shopping. We also saw very strong digital demand for some of our newer categories such as digital health and fitness, at-home fitness equipment, sustainable living, outdoor activities and camping equipment. While still relatively small categories from a revenue standpoint, they are extremely relevant in today's environment and highlight our ability to leverage our digital-first mindset supported by our expertise around curation and supply chain.

Throughout the quarter, we experienced inventory constraints in a number of categories which did moderate our sales growth. While we expected product constraints as we entered the quarter, the stronger-than-anticipated demand as we opened our stores for shopping resulted in more constrained products' availability than we expected.

Turning to profitability. Our Q2 non-GAAP operating income rate of 5.9% expanded almost 200 basis points from last year due to materially lower SG&A expense. The lower SG&A is a direct result of balanced but prudent decisions to lower costs in response to the uncertainty of the pandemic and our evolving operating model. That level of lower SG&A, for the most part, is not sustainable as we add labor hours in our stores, reinstate short-term incentive plans and increase advertising spend. Matt will provide more detail later, but we expect Q3 SG&A expense to be more in line with last year's third quarter.

I would like to take a moment to recap the evolution of our store operating model. We ended Q1 in a curbside-only model with no in-store customer shopping. At the beginning of Q2, we started welcoming customers back into our stores by offering an in-store consultation service to customers by appointment only. On June 15, we began allowing customers to shop without an appointment at more than 800 stores across the U.S., and as of June 22, almost all of our stores were open for shopping.

At that time, approximately half of the 51,000 associates who had in furloughed in April returned. We also resumed our in-home sales consultations, adding to the other in-home services we provide like delivery, installation and repair, we had previously resumed back in May. As we reopen our stores, we saw considerable demand from customers who clearly value and want an in-store shopping experience.

Prior to reopening, we were retaining approximately 92% of last year's revenue at the start of Q2. Then in the last 7 weeks of the quarter, total sales grew 16% compared to the same period last year. Trends have remained strong in August, with sales up approximately 20% for the first 3 weeks of Q3, as customers demand for products that help them work, learn, cook and entertain from home continues. To meet this increased demand, we have now returned approximately 2/3 of the furloughed associates.

Throughout this time period and across all the ways customers can shop, we have continued to adhere to safety protocols that limit capacity, follow strict social distancing practices and use proper protective equipment, including requiring our employees and customers to wear masks. Like many retailers, we are also operating at reduced store hours. And after reopening our stores, we were operating with approximately 20% fewer hours than last year to match customer demand patterns.

This pandemic and the swift shift in customer buying behavior really underscores the importance of our strong multichannel capabilities. For the full quarter, our Domestic online revenue grew 240% from last year. Even when stores opened for customer shopping, online sales growth continued to be extremely strong. In fact, in the last 7 weeks of the quarter, online revenue grew approximately 180% over the same period last year. Domestic online sales have continued to be very strong in Q3 and are up approximately 175% for the first 3 weeks of August.

We believe it is essential to provide options that let customers choose what works best for them. We are continuing to provide fulfillment options customers have come to expect from all retailers like fast and free home delivery, and buy online and pickup in store. We will also continue to provide great experiences like curbside pickup, in-store consultations and, of course, home installation of appliances, TVs, fitness equipment and more. And our digital experiences, such as chatting with an expert or leveraging a digital consultation in your home, remain popular options.

During the first half of the year, in responding of the pandemic, we made decisions across all these operating models that stressed safety. Although we temporarily gave up some share while our stores were closed to customer traffic, according to our data, our share has largely recovered since reopening. Most importantly, we made the right decisions for our employees and customers. In Q2, more than 97% of customers surveyed indicated that we made them feel safe and we believe the credibility we garnered will, over time, contribute to more brand love and thus more revenue.

I would add that since the beginning of the pandemic, we have seen elevated growth in the number of new customers. And while it is still early, these new customers are showing a higher likelihood to return than new customers in the prior year period. As we look forward, the environment is still evolving and our operating model and supporting cost structure is evolving as well. The pandemic has accelerated the evolution of retail and compelled us to change our operating model in the best interest of our customers and employees. It has also allowed us to expedite some planned strategic changes that will set us up to emerge from this time even stronger.

I'd like to provide some insight into our approach, starting with 3 concepts we believe to be permanent and structural implications of the pandemic. One, customer shopping behavior will be permanently changed in a way that is even more digital and puts customers entirely in control to shop how they want. Our strategy is to embrace that reality and lead not follow. Two, our workforce will need to evolve in a way that meets the needs of customers while also providing more flexible opportunities for our people. And three, technology is playing an even more crucial role in people's lives due to the pandemic. And as a result, our purpose to enrich lives through technology has never been more important.

Said differently, people are using technology to address their needs in ways they never contemplated before, and we play a vital role in bringing tech to life for both customers and our vendor partners. As you would imagine, these concepts are extensive and interdependent, and we are both implementing change today and assessing future implications across our business. These implications have been considered as we have made decisions throughout the course of the pandemic and will help shape our strategy for our future store design, our operating models and our digital investments. We will provide more examples as our plans evolve, but here are some initial thoughts on strategic implications over the next several quarters.

From a store standpoint, we have been responding to the impacts from the pandemic in a way that has been enabled by tremendous flexibility at the local level. We are leveraging localized data and analytics that allow us to pilot various services, like opening stores an hour earlier for consultations only. Using data and analytics also allows us to quickly and productively customize operations to the local situation if necessary. This is especially important for us to effectively respond should the virus flare up in certain markets.

It is too early to know exactly how much of our sales and customer shopping activity will be via digital channels over time. But as a result of the pandemic, we expect it will be higher than it has been historically. As a result, we are starting to evolve the way we use our stores for fulfillment. For example, next month, we will be piloting a ship-from-store hub model to help handle significant volume pre-holiday and year round. All our stores will still ship out online orders, but approximately 250 locations will be positioned to ship out significantly more volume. These locations

were chosen for their space, proximity to carrier partners and ability to support same and next-day delivery. Over time, this should allow us to deliver a more productive fulfillment model.

We are also continuing to add additional third-party physical pickup locations for online orders to provide more flexibility and convenience for customers, and now have more than 16,000 covering 85% of the population within 5 miles. As it relates to our people, we are investing in compensation and beginning to incorporate elements of the flexible workforce we first introduced at our Investor Day a year ago. We took a major step earlier this month by evolving the pay structure for our store employees and raising the starting wage to \$15 per hour.

Since the early stages of the pandemic, all hourly retail associates and supply chain employees who were working received incremental hourly appreciation pay. The incremental hourly appreciation pay started March 22 and ended August 1. On August 2, the beginning of our third quarter, we implemented a new pay structure that reflects an ongoing evolution and is the result of clear and consistent feedback from field employees across the country.

To provide more predictability and pay, a 4% increase in hourly rate replaced short-term incentive compensation for hourly store employees below the leadership level. After the 4% hourly pay increase, employees who are not yet at \$15 per hour had their pay increased to the \$15 per hour starting wage. For field leadership and corporate employees, we are reinstating short-term incentive compensation programs for the back half of the year.

Since the beginning of the pandemic, we've worked in partnership with our company founder, Dick Schulze, to provide our employees with emergency financial assistance. Together, we've established 2 funds totaling more than \$10 million, one for the benefit of any full or part-time employee meeting general financial help and a second for those who have become ill with the virus. We are also evolving the way we work to position employees to serve customers based on need, irrespective of channel. A few early examples include our consultation program and our Geek Squad agents.

As most of you know, we launched our In-Home Advisor program a few years ago. At that time, the program consisted of highly trained individuals who were strictly going into customers' homes to provide free comprehensive technology consultations. In May, we developed an in-store appointment engine as we adapted our operating model to respond to the pandemic. As a result, our In-Home Advisor program has morphed into a consultation across all channels model. We now have a system with tiered advisers, which provides more opportunities for more employees by matching employees with the needs of the customer. And they can provide free consultation in stores, in homes and via phone or chat, depending on customer preferences.

Our Geek Squad agents are not only providing technical support to customers in stores, many of them have also been cross-trained to work in our call centers, providing crucial phone and chat support to solve a variety of customer needs. Another example of the way we are increasing the flexibility of our workforce is our store employees who are making same-day deliveries to customers' homes from 200 of our stores.

The examples I just shared have largely stemmed from our response to the pandemic. Going forward, we are on a path to develop a flexible workforce model that leverages technology and provides associates the ability to work whenever and wherever they want. Right now, we are building the foundation by leading our store employees through skills-based training for their existing roles. Over time, there will be opportunities for employees to gain additional skill sets and be able to fulfill multiple roles, which will lead to additional scheduling, eligibility and flexibility.

From a customer experience standpoint, our strategy is to not only keep pace with but anticipate changes in customer expectations, including safety, by adopting a customer-obsessed approach that is primarily digital. I'll share a few examples of how this is showing up in our app, which saw the number of customer downloads double compared to last year. We are piloting more opportunities for virtual consultations with our Blue Shirts and in-home consultants, including abilities to share live video. This is especially critical during the current environment and increase the need for remote consultation and assistance capabilities.

We are also expanding our use of augmented reality in the shopping experience. So customers can more easily select the right products based on the space in their homes by using the camera on their own phone. For the in-store experience, we are piloting a self-service, in-aisle checkout for selected SKUs. This will allow a checkout process that is fast, convenient and involves minimal contact for customers. And for our curbside pickup

experience, we are adding functionality that will display information about high and low traffic times and provide digital updates for customers when they are in the parking lot waiting for their curbside orders.

We will continue to add features and capabilities to the app to drive frequency, retention and personalization opportunities, all of which are significantly higher in the app than other digital channels.

As it relates to the third implication of the pandemic, one of the ways in which technology is playing a more crucial role in our lives is related to health. For Best Buy Health, our focus on digital health, in particular helping seniors live more independently with our unique combination of tech and touch, has become even more relevant as the world responds to the pandemic and concepts like telehealth become more mainstream. We continue to expand our assortment of health-related products and, looking forward, see this as an area of technology innovation we are uniquely well suited to help customers navigate.

We recently announced to our employees, a new President of Best Buy Health, Deborah DiSanzo, who will start in September. Deborah has more than 30 years of experience at the intersection of health care and technology, including leading the IBM Watson health team, where she launched artificial intelligence offerings designed to help doctors, researchers, health care providers, pharmacists and insurers better serve patients around the world. She's also the former CEO of Philips Healthcare, where she helped bring consumer-grade automatic defibrillators to the market.

She is a recognized thought leader in artificial intelligence and big data, has deep experience in running businesses known for their innovation in health care and has a demonstrated ability to drive growth both organically and through acquisitions. We are excited to have her lead our strategic work to bring health technology into the home to help people live better, safer and more independent lives.

Before I conclude my prepared remarks, I want to talk about our ongoing commitment to diversity and inclusion in our community. We are always striving to attract and invest in talent that reflects the diversity of all communities and fosters an inclusive culture across the organization. We're powered by the belief that our people matter most and diverse perspectives make us better. Our culture of inclusion values every human being's experience and supports each employee to bring their true and authentic cells to work.

Our efforts have not gone unnoticed. Earlier this year, the Human Rights Campaign named us a Best Place to Work for LGBTQ Equality. And Forbes Magazine named us on its list of America's Best Employers for Women. We were also recently named one of Parity.org's Best Companies for Women to Advance. In the wake of George Floyd's death and the subsequent protest, Best Buy is committed to doing better when it comes to taking action to address racial inequities and injustices. We've created a diverse task force within the company to help us define and create meaningful change, and we will provide visibility to our corresponding commitments in the near future.

We've also committed to creating more than 100 Teen Tech Centers to help bridge the opportunity gap and digital divide for teens in disinvested communities across the country. And we're one of the leaders in a new public-private partnership called ConnectedMN that will provide computers and Internet access to thousands of youth in our home state. Finally, we have signed on as a founding member of the Parity.org ParityPledge in support of people of color. This is a public commitment to interview at least one qualified person of color for every open leadership role that is at the Vice President level or higher, including the C-suite and Board of Directors.

In conclusion, we delivered very strong Q2 financial results in an environment that continues to evolve. We are executing well and also clearly seeing benefit from the need for people to connect, work, learn, cook and entertain at home. Looking back, it was only 5 months ago that we closed our stores to customer traffic, drew down the full amount of our revolver, made the difficult decision to furlough associates and saw total sales declines reach 30% at one point.

Throughout the pandemic, we have been confident that we will emerge an even stronger company than we were before. Clearly, we are still operating in a dynamic environment, and much uncertainty remains around future outbreaks, government stimulus efforts and the economic impact of sustained high unemployment levels and ongoing shutdowns that vary by industry. We are cognizant of all these factors. At the same time, we are encouraged by our clarity of purpose and our momentum, which has guided and will continue to guide our operating model changes and investments.

Our purpose to enrich lives through technology is more relevant than it has ever been, and we are confident regarding our execution, adaptability and the opportunities ahead. We will continue to invest in those capabilities that focus on the customer experience over the long-term and that are designed to provide choice, speed and now safety.

Now I would like to turn the call over to Matt for more details on our Q2 financial results.

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**Matthew M. Bilunas** - *Best Buy Co., Inc. - CFO*

Good morning. As Corie highlighted, the demand for our products and services was remarkably strong during the quarter. Although we didn't provide guidance for the quarter during our last earnings call, we shared a belief that our Q2 sales would be pressured, and we would experience a decline in our operating income rate.

Ultimately, as we continue to see increased demand for our products, our ability to open almost all of our stores to customer traffic much sooner than we had expected resulted in the stronger-than-anticipated results. And while we are pleased with the financial results and our team's ability to navigate the rapidly changing environment, we also know that our goals reach beyond any 1 quarter's results, and we still face an uncertain environment.

On enterprise revenue of \$9.9 billion, we delivered non-GAAP diluted earnings per share of \$1.71 or an increase of 58% versus last year. As a percentage of sales, our non-GAAP operating income of 5.9% increased 190 basis points compared to the prior year. As Corie mentioned, the primary driver of the operating income rate expansion was lower non-GAAP SG&A expense of \$219 million, which was 290 basis points favorable to last year as a percentage of sales.

Gross profit as a percentage of sales declined 100 basis points compared to last year, which partially offset the SG&A favorability. In relation to SG&A, we made several cost decisions in Q1, and as we entered Q2 to align with the lower sales and channel trends we were seeing and expecting to continue at that point. These included keeping store employees on furlough, suspending short-term incentives and lower advertising expense.

As we opened our stores, we saw significantly improved sales trends that outpaced our staffing levels for a period of time. These sales on a temporarily lower cost base resulted in incremental leverage that drove a more favorable operating income rate. I would now like to provide some additional details on our Q2 results.

In our Domestic segment, revenue for the total quarter increased 3.5% to \$9.1 billion. The increase was driven by a comparable sales growth of 5%, which was partially offset by the loss of revenue from 25 stores that are permanently closed in the past year as part of our normal course of business. As a reminder, our comparable sales calculation includes revenue from all stores that were temporarily closed or operating in our curbside-only operating model during the period as a result of COVID-19.

Domestic online revenue of almost \$5 billion was 53% of Domestic revenue, which was up from 16% last year and 42% in Q1 of this year. On a comparable basis, our online revenue increased 242% over the second quarter of last year. Buy online and pick up in-store or curbside was 41% of online sales. I want to note that approximately \$5 billion in revenue represents the most online revenue we have ever generated in a single quarter in the company's history, surpassing our previous all-time high by almost 40%.

From a merchandising perspective, as Corie mentioned, the largest comparable growth categories were computing, appliances and tablets. This growth was partially offset by declines in mobile phones and digital imaging. Home theater comp sales were approximately flat to last year, a material improvement from Q1's performance as trends continue to improve as we open our stores to customer shopping.

Additionally, television specifically saw a year-over-year comp sales increase. Our gaming category was also approximately flat to last year. While strong demand continued across the category, sales of accessories like controllers and headsets was offset by constrained inventory availability of gaming consoles.

Comparable sales in the services category declined approximately 9%. The decline in services was primarily due to a higher mix of online sales, which has a lower attach rate than in-store. Within the quarter, our sales growth continued to improve as our stores reopened. In our International segment, revenue increased 9.4% to \$782 million. The increase was driven by comparable sales growth of 15.1%, which was partially offset by 490 basis points of negative foreign currency impact. The growth was primarily driven by Canada, where we experienced similar trends in our Domestic segment from a product category standpoint, and we were able to open almost all locations without appointment approximately 2 weeks sooner than we did in the U.S.

Turning now to gross profit. Domestic gross profit rate declined 120 basis points to 22.8%. The decrease was primarily driven by supply chain costs associated with the higher mix of online revenue. We also saw lower profit sharing revenue from our private label and co-branded credit card arrangement, which impacted our gross profit rate by approximately 20 basis points. Our gross profit rate as a percentage of sales was higher than our expectations going into the quarter, driven by a more favorable promotional environment and a higher mix of sales from the stores channel.

Moving to SG&A. Domestic non-GAAP SG&A decreased \$195 million compared to last year and as a percentage of revenue, decreased approximately 280 basis points. The largest drivers of the expense decline were: one, lower store payroll expense of approximately \$100 million; two, lower advertising expense of approximately \$40 million; three, lower incentive compensation expense of approximately \$30 million related to both field and corporate employees; and four, lower medical claims expense of approximately \$25 million.

Let me share a little additional color on the lower store payroll expense. The lower store payroll expense represents a number of components, but the primary driver was fewer labor hours for our associates. The fewer labor hours were primarily due to stores being closed to non-appointment traffic for approximately half of the quarter and our reduced store operating hours. This decline in labor hours was partially offset by higher hourly wage rates, mainly incremental appreciation pay for those who are working in our stores throughout the quarter.

Our International SG&A decreased \$24 million compared to last year. And as a percentage of revenue, decreased approximately 500 basis points, primarily due to lower store payroll expense in Canada and the favorable impact of foreign exchange rates.

Moving to the balance sheet. We ended the quarter with \$5.3 billion in cash. During the quarter, we repaid the full amount of our \$1.25 billion credit facility that we had drawn in March. At the end of Q2, our inventory balance was approximately 21% lower than last year's comparable period, whereas our accounts payable balance increased 31%. The health of our inventory remains strong and the lower inventory position reflects the inventory challenges Corie referenced earlier.

During the second quarter, we returned \$143 million to shareholders in the form of dividends. From a capital expenditure standpoint, we still expect to spend in the range of \$650 million to \$750 million during fiscal '21. Lastly, let me finish by sharing a few comments about the back half of the year.

As a result of the ongoing uncertainty, we are not providing financial guidance today. However, I would like to provide some insights into how we are thinking about Q3 and the rest of the year. Overall, as we plan for the back half of the year, we continue to weigh many factors, including a potential future government stimulus actions, the current shift in personal consumption expenditures from areas like travel and dining out, the possible depth and duration of a pandemic, the risk of continued higher unemployment and the availability of inventory to match customer demand.

With that said, as we enter Q3, there continues to be a heightened demand for the products and services we offer. It is difficult for us to know how sustainable these sales trends are considering the factors I just noted. We are planning for Q3 sales to be higher compared to last year, but likely will not continue at the current level of approximately 20%. We also have plans in place that will allow us to adapt quickly if we needed through the remainder of the year.

We anticipate that our Q3 gross profit rate will continue to be pressured compared to last year, as we expect online sales will continue to be a higher percentage of our overall sales mix compared to the prior year. We also expect lower profit sharing revenue from our credit card arrangement.



As Corie mentioned, we expect our Q3 SG&A dollars to be very similar to last year's Q3. We expect the combination of our pay evolution changes and the store labor hours we have planned for our current operating model will actually result in slightly lower store payroll expense in Q3. We expect this will be offset by higher advertising expense as we prepare for our earlier start to the holiday season as well as increased variable costs from the anticipated revenue growth.

On a sequential basis, we expect the increase in SG&A dollars versus Q2 will primarily be driven by increased store labor hours. Reinstatement of short-term incentive plans and the increase in advertising expense.

I will now turn the call over to the operators for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We will begin with Steve Forbes with Guggenheim Securities.

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

Maybe just to start with now what you finished there on expenses. As we think back to the Analyst Day last year and the \$1 billion cost reduction program, I think you spoke to in the fourth quarter \$160 million of savings against that plan in the back half of last year. Can you update us on where you guys are today? Because the expectation for flat expenses in the third quarter seems to assume some reinvestment. And understanding the variable cost pressure here, but the 2/3 of furloughed associates have returned. Just trying to understand what's driving the lack of flow-through right on the achievement against those -- the cost reduction program?

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### Matthew M. Bilunas - Best Buy Co., Inc. - CFO

Sure. Yes, from a cost reduction standpoint, clearly we did a number of temporary actions and decisions to navigate through Q1 and Q2. And as has been our brand for years, we will continue to look for cost efficiencies to help improve our cost basis. We're in a very unique time frame right now to determine exactly how much is structural or permanent reductions.

And so we will update people as we go through the remainder of the year and into next year. But we do see permanent savings as we move through this time. It's really difficult to determine exactly how much. I would say as you move from SG&A into Q3, the sequential change, as we talked about, was really looking at increasing store labor hours with the assumption that stores will be open to customer traffic for the whole quarter.

And if you look at store labor hours in total, while we are increasing labor hours for them being open and also -- we've also increased the hourly wage rate. So with those 2 included, we still have store labor hours that are slightly lower than last year.

So we do believe we're finding some leverage as we move into Q3. We did say that Q3 sales are actually going to be higher in Q3, exactly how much, we don't know. But with a similar SG&A level in Q3, with higher sales, we would expect SG&A leverage to continue in Q3. Exactly how much, we'll determine by how much sales we actually have and how much gross profit rate pressure we'd be able to offset.

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

And then a quick follow-up, maybe sticking with the margin, just on gross. You talked about 2 pressures, right, in the third quarter, channel mix, right, and profit sharing, but you didn't mention promotions or mix. As we think about entering the holiday selling season here, what is sort of the promotional calendar looking like from your perspective today?

**Matthew M. Bilunas** - *Best Buy Co., Inc. - CFO*

Sure. To be clear, in Q2, the primary gross profit rate pressure we saw was coming from supply chain in the form of higher parcel expense. As a reminder, we had 53% of our business done online versus 42% in Q1, so parcel expense is the biggest gross profit rate pressure. And then in addition to that, we continue to see pressure from the lower profit sharing from the Citi relationship we have. Those are expected to continue into Q3.

Promotionally, we actually expected it to be a little bit more promotional going into Q2. It was actually a little less than we actually expected as we work through the quarter. If you look at promotionality into Q3, we would expect that promotionality to be sequentially up from Q1 and Q2, but still not a year-over-year pressure. There are a number of changes to the events and promotions in Q3 that we're obviously working through, but we wouldn't expect it to be a year-over-year pressure at this point.

**Operator**

And now we'll move to our next caller. We will hear from Chris Horvers with JPMorgan.

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

So I wanted to dig in on some of the category trends that you're seeing in August -- or July and August, whatever you think is a better lens to look at it through. What are you seeing and sort of what I would describe as sort of post back-to-school category? So are you seeing home theater and TV up? Are you seeing wireless up? What about gaming in advance of the 2 new platforms? And is -- and to what degree is this still all driven by or largely driven by back-to-school and work from home categories?

**R. Michael Mohan** - *Best Buy Co., Inc. - President & COO*

Chris, thanks for the question. We're seeing favorable trends across literally all of our categories right now as we exit Q2 and start Q3 with the one exception that we noted around mobile phones. But we're seeing trends that are applicable to every part of learning, working, entertaining and cooking from home. And some of that in Corie and Matt's prepared remarks are impacted by the fact we don't have as much inventory as we would like to have right now. But the demand curves that we saw when we opened our stores have continued as we've entered into August well beyond just the traditional back-to-school categories. So I hope that gives you a little bit of color.

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

Can you share with us, perhaps, like what you're seeing in home theater as an example on a quarter-to-date basis?

**R. Michael Mohan** - *Best Buy Co., Inc. - President & COO*

I can't give you the details of quarter-to-date, but we did talk about the improvement in our television performance. I think that's pretty reflective of the -- both the importance of the role we play in the TV or the electronics industry and the importance of stores play because we switched from a negative trajectory in Q1 to a positive trajectory. And our second quarter also includes lapping last year's Prime Day business, where we do a lot of revenue with our own exclusive models with our Amazon Fire TV. So we see the consumer demand strong. We see the demand is strong for larger products and for things that have additional features, higher resolution and clearly bigger screens as people are spending more time at home.

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

Understood. And maybe can you talk about, as my follow-up question, the gross margin mix in the -- I would have thought in the second quarter you would have seen a pretty solid gross margin mix headwind. Was that essentially fully offset by a lower promotional posture year-over-year? Or was the net of those 2 things actually positive?

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**Matthew M. Bilunas** - *Best Buy Co., Inc. - CFO*

Yes. We're not going to give specifics. But largely, the product mix that we experienced in Q2 was fundamentally offset by the promotional -- favorable promotional environment that we saw in Q2. And we would expect the product mix to continue similarly in Q3, assuming computing continues to be a higher mix of our business. And as we've said, promotionality will likely be a little bit more in Q3. We'll see how it ends up, but a little bit more than Q2. And to the extent how much it is favorable will determine how much it offsets the mix impact.

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**Operator**

(Operator Instructions) I'll now move to your next question, Peter Keith with Piper Sandler.

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**Peter Jacob Keith** - *Piper Sandler & Co., Research Division - Director & Senior Research Analyst*

Nice execution here. I wanted to look at the margin differential between the retail stores and e-comm. Historically, you've highlighted that e-comm has a lower contribution margin. But now just considering the stronger digital sales going forward, are there efforts to maybe close the gap between those 2 margins and perhaps bring them in line in future quarters?

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**Matthew M. Bilunas** - *Best Buy Co., Inc. - CFO*

Yes. In the past, we've talked about the 2 channels. First, it's really hard to parse out exactly the 2 different P&Ls between online and store. Overall, on an annual basis, the EBIT levels of both of those channels are actually pretty similar. Now each quarter can be a little bit different. The makeup is a little different, too. Online has typically had a little less -- a little more -- a little lower gross profit rate but a little bit more SG&A leverage. Stores, while it carries a little bit more gross profit rate, it carries a little bit more SG&A burden. So they kind of offset each other, and so similar EBIT levels -- or they're pretty similar EBIT level.

And when you go through what we saw in Q1, that dramatic change of online sales -- going to online sales, you can't necessarily correct right away in those periods. So what we've done is made some prudent and necessary steps to kind of look at our SG&A structure. And as we go forward, we'll obviously be looking at how to improve the efficiency of whichever channel we have.

I'd say over the years in online, we've actually been improving our gross margin rates. And even over this period of time, we've seen better attach rates during the times our store were closed in Q1 and Q2. So we will continue to improve the customer experience to kind of improve the gross margin rates online and continue to look at our cost structure overall for both channels.

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**Peter Jacob Keith** - *Piper Sandler & Co., Research Division - Director & Senior Research Analyst*

Okay. That sounds encouraging. And maybe on a more near-term question. With the commentary about sales growth up 20% in Q3 and you would expect that to moderate. Certainly, I think that's a good stance to take. Although what I'm asking is, are there identifiable aspects of the sales growth today that you think will go away, whether that's back-to-school or some other category that's abnormally strong right now?

**Corie Sue Barry** - *Best Buy Co., Inc. - CEO & Director*

Peter, I'm going to take that one. I think there are a few -- I would characterize them more as unknowns as we look into the back half year. And I would cite things like where we are in the government aid programs and whether or not there will be a new package going forward.

Obviously, the stimulus, to some extent, has helped certainly up to this point. And it's hard to say how long that kind of hangover effect of that continues. I think there's questions around overall sustained unemployment levels. And also school opening and closing decisions and how long those stretch out in the period. And then, of course, we've highlighted inventory availability and mall retail strongly, all of our vendor partners are doing everything they can to catch back up.

You're talking about holiday levels of manufacturing and fulfillments, and that just is going to take a bit of time to catch trends this tight. And then finally, the actual duration and depth of the virus and how that proceeds through the fall. And so I think it's less about distinctly calling out categories, Peter, and a little bit more about just the environment that we find ourselves in.

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**Operator**

And now we'll take the question from Michael Lasser with UBS.

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

You noted that your share has largely recovered. Why wouldn't you be gaining share, especially as your stores are now open and you're growing sales 20% quarter to date?

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**Corie Sue Barry** - *Best Buy Co., Inc. - CEO & Director*

So we believe we continue -- we said it in Q1, we lost some share and we saw that trend continue again because our stores were largely closed. And we also said we view that as very temporal in nature. And you're right, we said in the script that we've seen the share recover. There are puts and takes week-to-week, honestly, Michael. There are some where we actually believe we're gaining. There are others where we think it's a little bit more moderate. Sometimes that can depend on the -- even inventory position at the time.

But overarchingly, we feel pretty strongly that we are in a good share position. And I think our key is that we continue to remain incredibly focused on providing the experience that we would expect seamlessly across the channels, still with an emphasis on safety. And we definitely see that in our customer responses. They're very favorably responding to the environment that we're creating. And so I think the team has done a very nice job across however the customer wants to shop, meeting their needs. And I think we're very well positioned as we head into Q3 into the back half from a share perspective.

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

And Corie, my follow-up is you discussed that SG&A expenses will be similar to last year in the third quarter. You just operated with a new model that showed you can perform pretty well without having to incur as much of an operating expense burden as you had in the past. So what's prompting your view that you need to go back to a full expense rate?

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**Corie Sue Barry** - *Best Buy Co., Inc. - CEO & Director*

Yes. I think -- one of the reasons we did the walk of our different models in the script was so everyone understood that we operated the first 6 weeks on an appointment only model. And obviously, we saw demand for people wanting to come back into our stores. We opened and we said at that point we brought back about half of our furloughed associates.

Honestly, the demand was so high as we opened the stores back up that we were not able to provide the level of service that we would have wanted. And you can see it in things like attach rate of services in the store. You could see it in how heavy the business was at our precincts and how many services people wanted to acquire. We literally didn't have enough people in the stores and hours in the stores to be able to handle that kind of demand. Hence, the reason we said that by the end of the quarter, we had 2/3 of our furloughed associates back in the hours associated with that, so we could meet some of that demand.

Now you're going to have a fully normalized quarter, where you're going to have both a new starting wage of \$15, but also what we think is the labor commensurate to meet the demand and provide the level of service that will help highlight our ability to provide services or financial services or lease-to-own or many of the other things that come with a full transaction for us.

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### Operator

We'll now take a question from Matt McClintock with Raymond James.

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**Matthew J. McClintock** - *Raymond James & Associates, Inc., Research Division - Research Analyst*

And congrats to the Best Buy team on good execution. I wanted -- 2 questions. The first one is just on supply chain, many fulfillment hubs for the stores that you're shifting to, to this model. Can you talk a little bit about your capacity to shift volume to that method? And then how do you think about the reduction in freight cost and the benefit that you'll get as you make this transition? That will be my first question.

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**R. Michael Mohan** - *Best Buy Co., Inc. - President & COO*

Matt, it's Mike. I'll start with the question. I think about it in 2 different ways. We were a pioneer in this whole idea of buy online and pick up in store, which allowed us to be the first major retailer to figure out how do we ship from store. And based on some of our store size, we have stores that have excess capacity, I think you're aware of some of our (inaudible).

And when we look at what we did for automation over the last 3 and the things that we had to do, it's very easy for us to receive products in our 7 RDCs and then put them on the normal truck runs out to the stores that we already do and if we need to run extra trucks out to these 250 locations, so we can actually have rapid replenishment.

And we've been able to use our analytics and algorithms to understand where the density in shipping volumes will come from. It's partially designed to lower expenses because we can absolutely have more customers pick up in-store, that's what's happening with these locations. But it's closer to our carrier delivery pads. It's also a place that we're launching our own same delivery with our Best Buy team members, which is a lower cost than using a third-party service.

So there's a mix of all of those choices that will, over time, we believe, deliver a lower partial fulfillment expense. But right now, our biggest priority is making sure when you're shopping on Best Buy's digital sites, and we talked about doubling the amount of app downloads, we really want to make sure when you're looking at the item you want, that to get it by data is accurate and it's competitive, and we feel very good about that. And that's the primary thing we're focused on for this holiday.

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**Matthew J. McClintock** - *Raymond James & Associates, Inc., Research Division - Research Analyst*

And then just my follow-up question is new leadership at Best Buy Health. Any strategic changes that you're thinking about on that business? Or just any new different direction that you're going to go with, given the various skills that she brings over?

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**Corie Sue Barry** - *Best Buy Co., Inc. - CEO & Director*

I mean our focus and confidence in the Health business remains incredibly strong. And obviously, the environment that we find ourselves in only reinforces that strategy. I think Deborah brings just exceptional experience combining technology with health care. This idea of tech and touch that we've talked about before, her life experiences in bringing those things together. So I think we found someone who has life experience that very closely aligns with where we think the strategy needs to go. And I wouldn't see the strategic point of view change very much, I just think that we have an ability to continue to accelerate our strategy.

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**Operator**

And Anthony Chukumba with Loop Capital Markets will have the next question.

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**Anthony Chinonye Chukumba** - *Loop Capital Markets LLC, Research Division - MD*

Congrats on another spectacular quarter. Also wanted to commend you on all your -- everything you're doing from a social justice perspective. So I have a quick question then a follow-up. You talked a lot about the shift to online. There's been different things we're doing in the store and the 200 stores are going to be hubs for the online -- for online deliveries. And I know it's early, but does that make you sort of rethink -- how do you think about what's the right number of stores going forward if you think a lot of this online shift is going to be permanent?

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**Corie Sue Barry** - *Best Buy Co., Inc. - CEO & Director*

Thank you, Anthony, for the compliments. And let me start by saying one of the implications we laid out in the script where we're talking of that customer shopping behavior has changed permanently. The customer is in charge. So this isn't about being seamless across channels, it's about being seamless for the customer.

And even at our Investor Day last year, we were talking about how the customer behavior was changing and accelerating, probably even moving faster than most retailers were. And so we've been building with this as the assumption, honestly. We've been improving our digital experiences. We've been building a phenomenal and flexible supply chain, and have employees in stores that are moving at speed with the customer.

Most of the capabilities that we've used, really on curbside but also in-store consultations, the cross-training in the stores. We do ship from all our stores not just the hubs, the hubs will be used to ship larger quantities. And 60% right now of what we're selling is flowing through our stores in some way, either curbside or in-store pickup or ship from store. And so this only underscores our belief that our stores are a unique and powerful asset for us.

And I think that what we will see is that the stores may be used differently. It's not about less stores, but it might be about more points of presence and a different ability to meet the customer. But we do think one of the unique assets that we have is our ability to move with speed and, frankly, put the customer in control to experience us whatever way they want.

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**Anthony Chinonye Chukumba** - *Loop Capital Markets LLC, Research Division - MD*

Got it. That's helpful. And then just for my follow-up. So you beat the consensus assessment by a country mile again this quarter. You repaid your entire revolving credit facility. You're sitting on over \$5 billion worth of cash. At what point -- and I know there's a lot of uncertainty out there, I'm living it, we're living it every day in this post-COVID dystopia as I do this call from my home office. At what point do you feel like we're at -- we've kind of gotten to the other side, we can start to buy back stock again?

**Matthew M. Bilunas** - *Best Buy Co., Inc. - CFO*

Yes. Thanks for the question. We're evaluating when we may resume stock buybacks. Fundamentally, our allocation strategy has not changed. We first -- we're always going to reinvest in our business to do what's right for our customers in the long term. We still plan to be a premium dividend payer and at some point return all the excess cash to shareholders.

I think, ultimately, you nailed it. This is a -- we're kind of in a very uncertain environment for many reasons. Holidays likely will be different. And as -- like many companies, we're taking the time to really evaluate when we might resume that. But right now, we like the position that we're in to be able to keep flexibility through the remaining part of this year, but we will certainly readdress that at some point.

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**Operator**

And next we'll hear from Brian Nagel with Oppenheimer.

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**Brian William Nagel** - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Very nice quarter. Congratulations.

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**Corie Sue Barry** - *Best Buy Co., Inc. - CEO & Director*

Thank you.

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**Matthew M. Bilunas** - *Best Buy Co., Inc. - CFO*

Thank you.

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**Brian William Nagel** - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

So the first question I want to ask, I think, Corie, you discussed in your prepared comments just the degree to which new customers come in to Best Buy. I think either stores or online is helping to drive the sales recovery. Maybe discuss just a little bit further the makeup of these customers, where they may be coming from, how different are they than the customers that Best Buy catered to in the past. I mean are we seeing now that the Best Buy brand is, through this crisis, actually reaching a new demographic?

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**Corie Sue Barry** - *Best Buy Co., Inc. - CEO & Director*

Yes. We're -- obviously, it's early, so we're still assessing exactly who all these customers are. I think it's at least clear for us that they are customers for whom we may not have been in the consideration set prior. And like we said in the prepared remarks, clearly, it's only been 5 months but some of those new customers we obtained in March have shown a much higher propensity to repeat sales than the new customers we retained last year during the same period.

Nicely, we have also seen our engaged customers start to rebound as we've reopened stores. So it's a little bit the best of both worlds, which is why we're so experientially focused on creating the environment, both safety and choice, that will make us appealing for all customers. So we'll continue to peel apart who those customers are. But honestly, our bigger priority right now is not just who they are, it's how do we reengage them, how do we continue to bring them into the Best Buy ecosystem and make them a little bit stickier to the brand. Which is why we talk about things like brand love, we talk about things like safety, because those become the measures by which the brand is valued over time.

**Brian William Nagel** - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Got it. That's helpful. Then as my follow-up, just unrelated. You talked, obviously, broad-based sales, right, in the quarter with the exception, as you called out, being the mobile category. So my question there is, is that -- do you think the weakness in mobile carry is more of a function of maybe a lack of product cycle or just the disruptions to the stores through most of the second quarter?

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**R. Michael Mohan** - *Best Buy Co., Inc. - President & COO*

Yes, I think you've got, actually both of the answers and a part of your question, is the one category that is most dependent on our store traffic for the customer experience to make sense. It's still complicated to do that process online, even some of the carrier stores aren't even open 7 days a week right now. So we're really focused on the customer experience in advance of new handset launches this fall on 5G.

We're still very excited about the category and the experience we create. We did make some enhancements so you can trade in your old connected device portfolio online because we're trying to be cognizant of what the customer is going to need. But it's one area where having our stores closed for a big part of the quarter probably played the biggest impact on the performance we just announced.

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**Operator**

We'll hear from Kate McShane with Goldman Sachs.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

I actually had just 2 quick follow-up questions to some that have already been asked. We wanted to ask about the acceleration that you're seeing in sales in August. Just what do you think is driving that, given the fact that's the stimulus had faded here a little bit. And just wanted to follow up on the promotional commentary, too, about why you don't necessarily see more pressure in Q3 year-over-year. Does it have to do with still trying to control traffic into the store or the tighter inventory levels?

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**Corie Sue Barry** - *Best Buy Co., Inc. - CEO & Director*

I'll start, Kate, and maybe Matt can follow some of that promotional commentary. In terms of the strength, and Mike had said it, we are really seeing broad-based strength. Now clearly, there is a work-from-home, learn-from-home component to this. And especially heading into back to school, you've got -- right now, our estimates are 2/3 of kids doing at-home learning. So that combination of learning at home and a lot of parents working from home and can't share devices, have to be able to have your own networks and own devices and own webcams and -- I mean, there's clearly a lot there. And that will be an extended phenomenon as it's going to have kids going back and forth probably some school to work.

But we're also seeing people want to entertain. We talked a little bit about gaming and the demand there. We thought that was a category that was going to be well down this year heading into new launches, and it's been performing. And it's not just about getting consoles, it's about the computing that's used for gaming as well, which has been incredibly strong. Mike talked about televisions and entertainment, and this idea back to sports and being able to start to at least watch sports again on devices. I mean everything that people are doing right now is on the back of technology in their home, and it completely underscores our purpose and our philosophy, and that is you actually right now are enriching your life through technology. And we're seeing it across basically every aspect of what we're selling in our stores.

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**Matthew M. Bilunas** - *Best Buy Co., Inc. - CFO*

Sure. And getting to the promotional question, I think what I said earlier was, promotionally, we'll probably be a little higher in Q3 than it was in Q2 and Q1, but fundamentally still not a pressure on a year-over-year basis.



In terms of Q3, I would -- we would still expect to see a heightened customer demand and just, overall, some level of inventory constraints as we work through the quarter. Clearly, as those change, it could affect promotionality. But with those 2 factors involved, I think we still expect to see not promotionality a little -- not a pressure on a year-over-year basis.

Clearly, the promotional cadence in events could change in Q3, and we -- holiday is -- will probably start earlier. But even with those, we believe that the demand for the products and services we sell and just also the inventory availability will continue to lend itself to the less promotional environment.

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**Corie Sue Barry** - *Best Buy Co., Inc. - CEO & Director*

Thank you. And with that, I want to thank you all for taking the time to join us today, and we look forward to chatting with you next quarter. Have a great day.

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**Operator**

Ladies and gentlemen, this will conclude your conference for today. We do thank you for your participation, and you may now disconnect.

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