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# EDITED TRANSCRIPT

BBY.N - Q3 2024 Best Buy Co Inc Earnings Call

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## OVERVIEW:

Company Summary

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## PRESENTATION

### Operator

ladies and gentlemen, thank you for standing by. Welcome to the Best Buy's Third Quarter Fiscal 2024 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded for playback and will be available for by approximately 1:00 p.m. Eastern Time today. (Operator Instructions). I will now turn the conference call over to Mollie O'Brien, Vice President of Investor Relations.

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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; and Matt Bilunas, our CFO. 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 GAAP financial measures and an explanation of why these 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 and subsequent 10-Qs 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.

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

Good morning, everyone, and thank you for joining us. For the third quarter, we are reporting better-than-expected profitability on slightly softer-than-expected revenue. Specifically, we are reporting a comparable sales decline of 6.9%, which is slightly below our outlook for the quarter as consumer demand softened through the quarter.

At the same time, we expanded our Q3 gross profit rate 90 basis points from last year due to profitability improvements in our membership program and better product margins. We also lowered our SG&A expense compared to last year as we tightly controlled expenses and adjusted our labor expense rate with sales fluctuations.

During the quarter, we grew our paid membership base and drove meaningful improvements in customer satisfaction scores across many of our service offerings, including in-home delivery, in-store services and remote support.

Our Q3 results demonstrate our ongoing strong operational execution as we navigate through the sales pressure our industry has been experiencing for the past several quarters. The sales pressure is due to many factors, including the pandemic pull forward of tech purchases, the shift back into services outside the home, like travel and entertainment; and inflation.

In the more recent macro environment, consumer demand has been even more uneven and difficult to predict. Based on the sales trends in Q3 and so far in November, we believe it is prudent to lower our revenue outlook for Q4. But despite the lower sales outlook, the midpoint of our annual EPS guidance is now slightly higher than the midpoint of our original guidance as we entered the year.

I want to thank our associates for their resilience and relentless focus on our customers. I continue to be so very proud of the way our teams are managing the business today and preparing for our future.

Now I would like to provide more color on our Q3 performance and holiday plans before passing the call off to Matt for the financial details on the quarter and our outlook. We continue to strategically manage our promotional plan, and we're price competitive in an environment where consumers are very deal focused and making spend trade-offs right for their budget.

Consumers are looking for value and from an industry themes perspective, we are seeing some trade down in the television category, but not as much trade down in other categories. As a result and as expected, the level of industry promotions and discounts were above last year and pre-pandemic fiscal '20.

Similar to the first half of the year, during Q3, our purchasing customers were relatively consistent in terms of demographics versus last year. As a reminder, we over-indexed with higher income consumers compared to the general population, and we saw the percent of revenue categorized as premium and the percent of purchases over \$1,000 remain constant versus last year.

We have largely maintained our year-to-date industry share in our Circana, formerly NPD tracked categories. Against this backdrop, our focus on deepening relationships with customers remains crucial.

Our membership program delivered another quarter of growth and improved profitability versus last year. The Q3 contribution to the enterprise operating income rate was larger than expected due to the combination of a lower cost to serve and higher paid in-home installation services.

For the full year of fiscal '24, we now expect our 3-tiered membership program to contribute approximately 35 basis points of enterprise year-over-year operating income rate expansion. It is still early since we introduced material changes in June, but there are a number of insights I would like to share.

One, we continue to increase our paid membership base and now have 6.6 million members. This compares to 5.8 million at the start of the year.

During the third quarter, we signed up approximately 35% more new paid members compared to the third quarter of last year, driven by the addition of the new tier and buoyed by back-to-school and October's member month events.

Two, our paid members continue to interact with the brand and shop more frequently compared to nonmembers, which is the goal of any membership program.

Three, and though it is early and we have not yet lapped the new programs, retention rates are outperforming expectations. Four, My Best Buy Total, which is the evolution of our prior Total tech offer, continues to resonate more strongly in our physical store setting.

As a reminder, this tier is \$179.99 per year and includes Geek Squad 24/7 tech support via in-store, remote, phone or chat on all your electronics no matter where you purchase them. It also includes up to 2 years of product protection, including AppleCare Plus on most new Best Buy purchases and includes all the benefits of My Best Buy Plus.

And five, our My Best Buy Plus is resonating more with the digital customers and appeals to a broader set of customer segments. This is the new tier for customers who want value and access. For \$49.99 per year, customers get exclusive prices and access to highly anticipated product releases.

They also get free 2-day shipping and an extended 60-day return and exchange window on most products. We are still early in the process and are testing different promotional offers to determine what resonates most with consumers as well as continuously improving digital experience to make it even easier to find deals and benefits.

Of course, we also have a free membership tier that enables free shipping for everyone, a great differentiator, especially in the holiday season. During the quarter, we continued to evolve our omnichannel capabilities to support our strategy and make it easy and enjoyable for consumers to get the best tech and premier expert consultation and service when they want it through our online store and in-home experiences.

Last month, we introduced Best Buy Drops, which is a new experience only available through the Best Buy app. It gives customers the opportunity to access product releases, limited edition items, launches and deals from a variety of categories. There are multiple drops nearly every week, and they're only available in limited quantities. We are encouraged by the early results as Best Buy Drops is driving both incremental customer app downloads and higher frequency of app visits.

We have also seen growth in sales from customers who are getting help from our virtual sales associates. These interactions, which can be via phone, chat or our virtual store, drive much higher conversion rates and average order values than our general dot.com levels. This quarter, we had 140,000 customer interactions by a video chat with associates, specifically out of our virtual store locations.

As a reminder, this is a physical store in one of our distribution centers with merchandising and products that are staffed with dedicated associates and no physical customers. We also teamed up with live shopping platform Talk Shop Live, to test a series of online shopping events this month, starring our virtual sales associates.

These events feature products from some of our newer categories like beauty and wellness as well as new tech and unique products. Our physical store portfolio is one of our key assets, and the role of our stores is to provide customers with differentiated experiences, services and multichannel fulfillment.

At the same time, we need some stores to be more cost and capital efficient to operate. As a reminder, while almost 1/3 of our domestic sales are online, 43% of those sales were picked up in one of our stores by customers in Q3. And most customers shop us in multiple channels.

Consistent with our normal cadence, we have largely completed the changes to our store portfolio for the year, so we can focus on the holiday season with minimal disruption to our physical stores.

As we think about next year with the current economic backdrop, we plan to spend more of our capital expenditures, refreshing a greater number of our stores and less on large-scale remodels. As such, we have 3 priorities for our U.S. store fleet in the near term.

Number one, we are refreshing our stores with a particular focus on improving enlivening the merchandising presentation given the shift to digital shopping and corresponding lower need to hold as much inventory on the shopping floor. For example, this year, in all our stores, we installed new premium end caps in partnership with key vendors that improve the merchandising in the center of the store.

This year, we installed up to 10 of these new end caps per store or roughly 1/3 of our end caps per store and plan to add more next year as we work to upgrade these crucial locations in our stores.

In addition, this year, we rightsized our traditional gaming spaces in roughly half of our stores to allow for the expansion of growing categories like PC gaming and newer offerings such as Greenworks cordless power tools, wellness products like the Oura ring, Epson short throw projectors, e-bikes and scooters and Lovesac home furnishing products.

While small, we are seeing promising results in some of these new categories with meaningful market share growth. And as always, we continue to work closely with our vendor partners to add experiences to our stores. For example, LEGO and Therabody invested in new shop-in-shops in all our 35,000 square foot experience stores.

In addition, and as you would expect, many of our premium partners are continuously updating their in-store spaces to reflect their latest innovations. We will continue this work next year in all our stores, rightsizing a number of categories to ensure we are leveraging the space in the center of our stores in the most exciting, relevant and efficient way possible.

Our second priority is to keep investing in formats we know drive returns. This year, we implemented 8 large format 35,000 square foot experienced store remodels for a total of 54 and will end the year with 23 outlet stores. At this point in time, we plan to implement a minimal number of remodels and outlets next year.

And the third priority is to open a few smaller footprint stores to keep learning and testing our hypothesis at physical points of presence matter, and we need less selling square footage and more fulfillment and inventory holding space.

In addition, we plan to open a few smaller stores in outstate markets to test the impact of adding new locations and geographies where we have no prior physical presence and our omnichannel sales penetration is low.

At the same time, we also continue to close existing traditional stores as a result of our rigorous review of stores as their leases come up for renewal. This year, we have closed 24 stores. Over the past 5 years, we have closed approximately 100 Best Buy stores, which is a 10% decline in store count during that time frame. And we expect to close roughly 15 to 20 stores per year in the near term.

We have been enhancing our supply chain network to support these footprint changes and deliver speed, predictability and choice to our customers. For example, we have worked to optimize our ship-from-store hub footprint to maintain substantial coverage for faster offers and take shipping volume pressure off the majority of the stores to allow them to focus on in-store and pickup experiences.

Additionally, we are optimizing our shipping locations to enhance our efficiency and effectiveness while still delivering with speed. And as a result, in Q3, we had the lowest ship from store volume as a percent of total since well before the pandemic, with approximately 62% of e-commerce small packages delivered to customers from automated distribution centers.

We also continue to augment our own supply chain through other partners and launched Best Buy on DoorDash marketplace, offering our second scheduled parcel delivery option in addition to Instacart Marketplace.

As we have discussed previously, we have made strategic structural changes to our store operating model over the past few years to adjust to the shifts we have seen in customer shopping behavior and our corresponding operational needs. These changes provide more flexibility and have allowed us to flex labor hours with the fluctuations in customer sales, shopping preferences like curbside and traffic.

As a result, we kept our labor rates steady as a percent of revenue, even as our sales have declined over the past several quarters. As you can imagine, there is a delicate balance to maintain while we adjust our store operating model as the expert service our associates provide customers is a core competitive advantage.

We keep a very close watch on our customer satisfaction trends to make sure we are not negatively impacting the customer experience. Broadly, I am proud that the team is doing this work while driving higher purchasing customer NPS for associate availability, product availability and pricing.

We are also committed, of course, to providing a great employee experience through training opportunities and benefits. As we mentioned last quarter, we have now led thousands of our sales associates through a certification process focused on our foundational retail excellence.

We are also leveraging technology in our stores more than ever to continue to elevate our customer and employee experiences in more cost-effective ways. A great example is our app built for employees called Solution Sidekick, that provides a guided selling experience consistent across departments, channels and locations. Our employees have embraced solution Sidekick and we can see higher customer NPS when our employees are utilizing the app in their interactions with customers.

We are gratified that our employee retention rates continue to outperform the retail industry, particularly in key leadership roles, the vast majority of which we hire internally. Our average tenure, excluding our seasonal workforce, for field employees is just under 5 years, and our general manager tenure is almost 16 years. This is crucial as we can directly tie tenured experience and training certifications to NPS improvement over time.

We have also seen a strong pool of applicants for new associates to supplement our store teams this holiday season. As you all have likely noticed, the holiday shopping season has begun. Since we are preparing for a customer who is very deal focused, we expect shopping patterns will look even more similar to historical holiday periods than they did last year with customer shopping activity concentrated on Black Friday week, Cyber Monday and the last 2 weeks of December.

From an inventory perspective, we expect to have strong product availability across categories this year. We will continue to manage inventory strategically to maximize our ability to flex with customer demand.

We are excited about the promotions and deals we have planned for all customers and budgets, including special promotions and early access to deals for our My Best Buy Plus and My Best Buy Total members. We have curated gift list to help everyone find the perfect gift. We also introduced a new resource on bestbuy.com and the Best Buy app called Yes, Best Buy Sells That where customers can find the latest in tech and gifting, like pet tech, baby tech or electric vehicle chargers, all the way to unique products, some shoppers may not know we sell like skin treatments, toys for all ages and electric outdoor power equipment.

For added ease of shopping and peace of mind, we've extended both our store hours and our product return policy for the holiday season. And this year, for the first time, we also extended that our shoppers can connect directly with one of our virtual sales experts to get help with their holiday shopping.

We're also offering free next-day delivery on thousands of items in addition to convenience store and curbside pickup options. Most orders placed on bestbuy.com or through the Best Buy app are ready for store pickup within 1 hour. Same-day delivery is also available on most products for a small fee.

From a merchandising perspective, we're excited for shoppers to see new innovation in a variety of categories, including AI-powered devices like Microsoft CoPilot and Windows 11 computers, the latest in virtual and mixed reality with Meta Class III or Ray-Ban Meta Smart Glasses, immersive audio with Bose QuietComfort ultra-headphones and more.

And we can help our holiday shoppers take advantage of this new innovation through our trade-in program, which gives the customer value for their old technology.

In addition to great deals for our flagship categories like computing, home theater and gaming, that feature our unique ability to showcase higher-end technologies at great value, we also have an expanded assortment of new and growing categories, including e-transportation, health and wellness and outdoor living.

Our e-transportation assortment has more options for people of all ages and skill levels. We have twice as many outdoor cooking brands compared to last year and more than 5,000 health and wellness products, including a lineup of fitness, recovery, beauty, skin care, baby tech and more.

As you can likely hear, we are very excited to provide customers an amazing experience this holiday season. Of course, the macro environment remains uncertain with some tailwinds and increasingly more headwinds, all contributing uneven impacts on consumers.

The job market remains strong and upper income and older demographics, in particular, continue to benefit from excess savings. Overarchingly, the consumer is still spending. But as we have said before, they are making careful choices and trade-offs right for their households. Given the sustained inflationary pressure on the basics, like food, fuel and lodging and the ongoing preference towards services spending, like restaurants, concert tickets indications.

Additional indicators have continued to soften, including declining consumer confidence increasing debt and waning savings, and we saw sales trends soften as we move through the quarter. This environment continues to make it challenging to predict shopping behavior even during the most exciting time of the year.

While we are lowering our Q4 sales outlook, we have a wide range to allow for a number of scenarios and the mid-to-high end of the range reflects sequential improvement. As we discussed on our last call, there are several factors supporting our belief that our Q4 year-over-year comparable sales can improve.

We expect home theater year-over-year performance to improve as we expect to be better positioned with inventory across all price points and budgets than last year. We are starting to see signs of stabilization in our TV units as they grew in Q2 and Q3 and are expected to grow in Q4.

We expect performance in our computing category to improve as we build on our position of strength in the premium assortment. Notebook units were flat compared to last year in Q2, down as expected in Q3 and expected to be up slightly in Q4. And we expect to see continued growth in the gaming category as inventory is more readily available and there are strong new software titles.

In summary, while the macro and industry backdrop continues to drive volatility, we have a proven track record of navigating well through dynamic and challenging environments, and we will continue to adjust as the macro conditions evolve. And we remain incredibly confident about our future opportunities.

After 2 years of declines, we believe the consumer electronics industry should see more stabilization next year and possibly growth in the back half of the year. While our existing product categories have slightly different timing nuances, we believe they are poised for growth in the coming years, benefiting from a materially larger installed base and the ongoing desire and need to replace technology as it ages.

Much of this replacement is spurred by innovation, and in addition, we continue to see several macro trends that should drive opportunities in our business over time, including cloud, augmented reality, expansion of broadband access and, of course, generative AI, where we know our vendor partners are working behind the scenes to create consumer products that optimize this material technology advancement.

Our purpose to enrich lives through technology is more relevant today than ever. We're the largest CE specialty retailer. We continue to hold 1/3 of the market share in both the U.S. computing and television industries and we can commercialize new technology for customers like no one else.

With that, I would like to turn the call over to Matt for more details on our third quarter results our fiscal '24 outlook.

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**Matthew M. Bilunas** - Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO

Good morning, everyone. Let me start by sharing details on our third quarter results. Enterprise revenue of \$9.8 billion declined 6.9% on a comparable basis. Our non-GAAP operating income rate of 3.8% declined 10 basis points compared to last year. Non-GAAP SG&A dollars were \$57 million lower than last year, and it increased approximately 100 basis points as a percentage of revenue. Partially offsetting the higher SG&A rate was a 90 basis point improvement in our gross profit rate. Compared to last year, our non-GAAP diluted earnings per share decreased 6.5% to \$1.29.

When viewing our performance compared to our expectations, we did not see the sequential improvement versus the second quarter that our third quarter outlook assumed. From an enterprise comparable sales phasing perspective, August decline of approximately 6% was our best performing month, with September down 7% and October, down 8%.

Although our sales were below plan, our non-GAAP operating income rate exceeded our outlook by approximately 40 basis points, which was driven by lower SG&A. The lower-than-expected SG&A was largely driven by tighter expense management in areas such as store payroll and advertising expense as we adjusted plans to account for sales trends.

Our gross profit rate was essentially flat to our expectations. Lastly, approximately \$20 million of vendor funding qualified to be recognized as an offset to SG&A while our outlook assumed it would have been a reduction of cost of sales. We anticipate similar recognition of this funding in Q4 in the range of \$15 million to \$20 million.

Next, I will walk through the details of our third quarter results compared to last year. In our Domestic segment, revenue decreased 8.2% to \$9 billion, driven by a comparable sales decline of 7.3%.

From a category standpoint, the largest contributors to the comparable sales decline in the quarter were appliances, computing, home theater and mobile phones, which were partially offset by growth in gaming.

From an organic perspective, the overall blended average selling price of our products was essentially flat to last year, which is a slight improvement relative to the past few quarters. In our International segment, revenue decreased 3.4% to \$760 million. This decrease was driven by a comparable sales decline of 1.9% and a negative impact of foreign exchange rates.

Our Domestic gross profit rate increased to 100 basis points to 22.9%. The higher gross profit rate was driven by the following: first, improvement from our membership offerings, which included a higher gross profit rate in our services category; second, our product margin rates improved versus last year, including a higher level of vendor-supported promotions and the benefit from optimization efforts across multiple areas; and third, lower supply chain costs.

Before moving on, I would like to give some additional context on the profit sharing revenue from our credit card arrangement, which performed better than we expected in the third quarter. On a year-over-year basis, the profit share has been approximately flat from a dollar perspective over the course of the year, which has resulted in a slightly positive impact to our gross profit rate. In the fourth quarter, we expect the profit share to come in better than we had expected and once again be very similar to last year from a dollar perspective.

As we look to next year, we expect the credit card profit share to be a pressure to our gross profit rate. At this point in time, we expect this pressure to be offset by continued financial improvement from our membership offerings.

Moving to SG&A. Our Domestic non-GAAP SG&A declined \$58 million with the primary drivers being lower store payroll costs and reduced advertising, which were partially offset by higher incentive compensation.

Next, let me touch on our inventory balance. Similar to last year at this time, we continue to feel good about our overall inventory position as well as the health of our inventory.

Our quarter end inventory balance was approximately 4% higher than last year's comparable period. As we noted during last year's third quarter earnings call, approximately \$600 million of inventory receipts came in a few days later than we had expected, moving from October into November. Adjusting for that timing shift, this year's ending inventory balance would have been approximately 4% lower than last year's targeted ending balance.

Year-to-date, we've returned a total of \$873 million to shareholders through dividends of \$603 million and share repurchases of \$270 million. We now expect share repurchases of approximately \$350 million for the year.



Let me next share more color on our outlook for the year, starting with our thoughts on the fourth quarter. From a top line perspective, we now expect our fourth quarter comparable sales to be down in the range of 3% to 7%. Our Enterprise comparable sales through the first 3 weeks of November are near the low end of the fourth quarter range.

On the profitability side, we expect our fourth quarter non-GAAP operating income rate to be in the range of 4.7% to 5%, which compares to a rate of 4.8% last year. Our fourth quarter gross profit rate is expected to improve versus last year by approximately 30 basis points. Although favorable to last year, the year-over-year improvement is less than the 90 basis points of expansion we reported for the third quarter.

From a sequential standpoint, there are 3 main items I would highlight that are expected to reduce the rate expansion in the fourth quarter relative to the third quarter. First, although it is still a benefit compared to last year, the changes to our membership offering are less impactful in the larger holiday quarter.

Second, product margin rates are expected to be closer to flat to last year in the fourth quarter compared to a benefit in the third quarter. And third, we expect supply chain cost to be a slight pressure in the fourth quarter versus a benefit in the third quarter.

From an SG&A standpoint, when comparing to last year, we expect our fourth quarter SG&A as a percentage of sales to be more favorable than our year-to-date trends, which is due in part to the impact of the extra week this year. The range of SG&A implied in the fourth quarter incorporates our normal course of actions to adjust variable expenses under the different revenue scenarios as well as adjustments to incentive compensation align with our expected financial outcomes.

As a reminder, we expect the extra week to add approximately \$700 million of revenue, which is excluded from our comparable sales and \$100 million in SG&A we still expect it to benefit our full year non-GAAP operating income rate by approximately 10 basis points.

Let me provide more details on our full year guidance, which incorporates the color I just shared on the fourth quarter. We now expect the following: Enterprise revenue in the range of \$43.1 billion to \$43.7 billion, Enterprise comparable sales to decline 6% to 7.5%, Enterprise non-GAAP operating income rate in the range of 4% to 4.1%.

Non-GAAP diluted earnings per share of \$6 to \$6.30, non-GAAP effective income tax rate of approximately 24%, and lastly, our interest income is still expected to exceed interest expense this year. Our full year gross profit and SG&A working assumptions remain very similar to what we shared last quarter.

And some of the key callouts are the following: we still expect our gross profit rate to improve by approximately 60 basis points compared to fiscal '23. A large driver of the gross profit rate improvement is expected to come from our membership offerings, which includes a higher gross profit rate in our services category.

Our membership offerings are now expected to provide approximately 35 basis points of improvement. At the midpoint of our guidance, we expect SG&A as a percentage of sales to increase by approximately 95 basis points compared to last year. We expect higher incentive compensation as we lapped up very low levels last year. The high end of our guidance now assumes incentive compensation increases by approximately \$140 million compared to fiscal '23.

And I will now turn the call over to the operator for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Your first question comes from the line of Simeon Gutman of Morgan Stanley.

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

I wanted to ask a question as we get into the fourth quarter, it looks like we'll have negative comps, and it will be the third year in a row. As we step back, I think there's logic to this massive pull forward and there is a larger installed base. There should be a replacement cycle. But I wanted to kind of question that. And if it throws any water on this, if there's something else happening here, maybe there is a lack of newness.

You mentioned that you didn't lose much share, but thinking about market share as well, but thinking about the cycles and whether we're not -- whether we could be in just a negative industry cycle for a little bit longer.

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

Thanks for the question, Simeon. I think we have a few things going on to your point. So if you think about the comments that I had in the macro section, you've got a variety of stacked issues happening. One is absolutely you had pull forward throughout the pandemic.

Two is you also have this kind of sustained inflation. And again, it's sustained inflation on the basics that we've been talking about food, fuel and lodging and so that's pulling people. We also talked about the fact that a lot of spend right now is geared towards the more service type of things like concerts, like trips. Everywhere you look, people are taking more and more vacations.

And so you have all of this kind of shift of spend that's happening. I think secondarily, as it relates specifically to the holiday time frame, the other interesting thing is people have also been buying CE a little bit more steadily throughout the year.

If you think about CE as more of a need-based item, not just that kind of giftable item, and so I think there's also just been a little bit of a shift in where people are spending. But I think broadly, what we're seeing reflected right now is the kind of culmination of not just pull forward, but all of these other factors that we're seeing from the consumer as they make those trade-offs.

And we've been using the words uneven for probably 6 quarters now, and I think that is what you're seeing in the variety of results from consumers and where they're choosing to spend their dollars.

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

Maybe the quick follow-up is the Q4, I guess, you're running at the low end. Does it get better because the comparison gets better? Or you're hopeful around how the big holiday sales end up playing out?

**Matthew M. Bilunas** - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Yes. I think the comparison certainly gets better. As you think about last year, we were about 3% lower than FY '20 levels. This year, we're lower again FY '20, but the sequential is better in Q4. I think there's still a lot of optimism for holiday. I think there's a lot of great holiday promotions and events.

And I think we're trying to temper any expectation on holiday just with the pragmatic view of where the consumer is at right now. And I think you commented on the share. I think we actually -- we say largely held share because it's really hard to actually get a good meaningful number on share, but we feel good about our share position as we go into the holiday period.

**Operator**

Your next question comes from the line of Chris Horvers of JPMorgan.

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

Thanks for the commentary around the credit card headwind that you're thinking about next year being offset by the membership. Can you talk about implicitly what you're assuming as a headwind in that comment, there's a lot of speculation. There's a lot of numbers getting thrown around in the market.

And so I just want to try to understand what you're implicitly assuming? And then -- in addition, what are the other big puts and takes in gross margin as you think about 2024, as you think about initiative spending as well as your health efforts?

**Matthew M. Bilunas** - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Sure. Thanks for the question. For credit card next year, I mean, obviously, there's a number of scenarios we're trying to understand as you think about next year.

So we're not really guiding next year now. But when we think about the credit card that pressure that we expect to see, we believe, will largely be offset by benefits we might see from the membership program and services category expanding a bit more from a gross property perspective.

The factors within the credit card, one of the biggest things we're trying to understand is just where do net credit losses go. They're -- at the moment, they're pretty close to where they were pre-pandemic. They were very low levels during the pandemic. And so we've been seeing them grow a little bit.

And so the question would be how high did those grow if they do grow into next year and what sort of pressure. The other factor to consider is that, generally speaking, our receivable balance is higher than it used to be over the last several years. And so a higher receivable balance and interest income obviously, you can offset some of those pressures as well.

So those are a couple of the bigger things we're trying to understand as we think about the credit card specifically. And as you mentioned, again, for next year, the other puts and takes. Again, we're not guiding next year, but that credit card pressure and the membership benefit is one of the bigger factors we're trying to understand.

Another one that I would call out would be -- we know that we're going to likely have to add STI expense back in as we're -- we've lowered the expense this year as we reset STI in the coming year to roughly \$85 million that we would likely add back.

Clearly, where the industry is at -- is a question as well to the extent that sales are flat or up, it helps relieve some of the pressure of some fixed costs. Clearly, the level of pressure matters quite a bit next year. If it's a small increase, small decline, it's less significant than is a bigger decline. So those are some of the bigger factors we're trying to think through as we go into next year.

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

So that's a perfect segue. On the SG&A side, Corie, I know you talked about your NPS scores with purchasing customers and what you're seeing in the store, you've caught what feels like a lot of labor over the past few years or past couple of years.

Are there any metrics that you're seeing, whether it's nonpurchasing customers, like close rates versus people walking indoor that are concerning to you? And then as you think about '24, given that you've gone negatively for this sustained period, is there just less flexibility to manage the labor component?

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

So I alluded to NPS being one of the factors that we -- you can imagine, there is a broad array of both operational and then more survey-based metrics that we're looking at, everything from how fast can we do an in-store pick, how good is the curbside experience. We specifically talked about and we can see meaningful improvements year-over-year in product availability, in associate availability, in a variety of products and pricing, and those have continuously improved even as this year has gone on.

And actually, we can also see some level of improvement in some of those through nonpurchasers as well. So we're watching both sides of this and that sequential improvement is happening across both purchasers and non-purchasers. And yes, we're watching close rate too, and the team is doing a really nice job measuring themselves and doing some progress against their close rate expectations as well.

So we are -- literally, we have the almost Rubik's cube of operational and customer survey-based metrics so we can assess. I think what the team has done a really amazing job at is your point around flexibility. You talked about do you have less. Interestingly, now we have associates who can opt into and get certified in not just multiple areas of expertise within the store, but they can also get certified for operations roles and sales roles, and they can actually move between stores within their markets.

And so we can flex not just against what's the consumer demand at the highest level, we can actually flex within a market depending on how and where people are choosing to shop. So I can even use an example like in the last week, we've seen a lot more people opting into in-store pickup and curbside and needing a bit more ship from store, and we can quickly then shift some of that labor into those areas, while still trying to strike the balance.

We also talked about even moving some of the ship from store out of stores using those automated facilities so that when we do have labor in the stores, it's more customer-facing. It's facing more some of these key areas where we're trying to deliver these experiences.

So not perfect and certainly not going to be perfect every single day at every single location, but we really are working hard, and I give the team a great deal of credit for every day, monitoring both the experiences and the operational metrics that will tell us whether or not we're delivering.

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### Operator

Your next question comes from the line of Peter Keith of Piper Sandler.

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

Nice to see the membership program changes coming a bit more accretive than initially guided. Could you help us unpack that a little bit in terms of the drivers, if it's just removing the free installation or maybe that middle tier is trending a little more profitable than you thought, maybe curious on what the uptick is from?

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**Matthew M. Bilunas** - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Sure. The main drivers of the improvement from a rate perspective are -- there's basically 4 main areas. The first is the points change to the My Best Buy program. The second would be just the growth in paid members over time and the recognition of those annual fees.

The changes we made to the total tech program, moving it to Total, mainly came through with lowering the cost to fulfill as we removed the free installation that also was part of the 35 basis points, and then again the resumption of appliance at home theater installation, paid installation is the other part of the number.

The main drivers of it coming in better than our expectations are around higher-than-expected paid installation volumes and then also lower-than-expected Best Buy claims and lower Apple premiums than we had expected.

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

Okay. That's helpful, Matt. And then in Corie, I guess everyone is very curious on product innovation and understanding we're kind of in this air pocket with very little innovation. But I'm curious are there any little green shoots that you're seeing in stores, maybe smaller products that we're not thinking about that give us some optimism that newness can drive sales.

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

Yes. I actually -- I mean, I might be biased, but I think there's a lot of green shoots that are out there. And you're right, back to the -- one of the first questions, definitely what has also caused the pullback in CE, and I didn't hit it, to begin with, I'll hit it now, is just a bit of a lack of innovation when everyone was trying so hard to produce as much as possible or pull back as hard as possible, we just haven't seen it.

Now we are starting to see a little bit of that turn toward innovation. What we can see, even in TVs, we can see there's a lot more interest in those large screen sizes. We can see growth in the like 77-inch plus kind of categories where people want to get that newness. We actually have doubled the amount of SKUs in the 97-inch and above TV category, which I know sounds insane, but those are really interesting things to people from a true entertaining at home perspective.

In majors, there's a brand-new washer/dryer combo unit from GE, so you can both do the washing and the drying in 1 unit, which is a really interesting innovation for people like me who might want to do 2 loads at once, full time and get through it all. In gaming, you can see there's really good availability of consoles, but some really interesting new titles that are driving some demand, some handheld gaming from ASUS and Lenovo.

Those are great. And then there's kind of some smaller just interesting things. We talked about the Meta Quest 3, the Meta Rayban sunglasses and not only can you capture pictures but has audio built in. And then I think there's lots of just really small fun giftable things, right?

There's everything from the automated bird feeder to the automated litter box and everything in between. So what's cool and the reason a little tongue in cheek, we mentioned the Best Buy sells that is there are actually a ton of really interesting fun consumer technology devices. And to your point, they're kind of small, but they're starting to lead the way into what I think will be more meaningful cycles as we head into the back half of next year.

As you think about, we mentioned generative AI and products and importantly, chips that geared toward running those kind of large language processing models. And you can imagine that will extend not just into computing, but into other areas. And we can't always talk about everything that we can see on the horizon, but we definitely can see some interesting products as our vendors, as you all know, are just as incented to stimulate demand as we are.

**Operator**

your next question comes from the line of Mike Baker of D.A. Davidson.

**Michael Allen Baker** - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Okay. Great. And this was sort of touched on, but the promotional activity, I think you said it's up. Where is it versus plan? Do you expect it to get more promotional as we get through the holiday season? And you said this year, it will be more traditional, i.e., Black Friday, Cyber Monday, the last two weeks, et cetera. Can you remind us how the holiday played out last year?

**Matthew M. Bilunas** - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Sure. Strategically, I think we've been done a really good job in managing our promotional plan overall. I think the promotions in terms of the discounts and mix of promotions are up versus last year, and in many cases, up compared to where they were pre-pandemic. Again, it hasn't necessarily manifested in our pressure on our product margin rates because we're still receiving a good amount of funding from our vendors to help stimulate the sales that you would expect us to want to do.

I think as you look about the holiday season, I think we are expecting the holiday to be a very sales-driven event. Consumers are looking for deals, and they're looking for value. And because of that, we believe it will look probably more closely to like it was pre-pandemic, where people are gravitating towards the big sale events around Thanksgiving and Cyber Monday and a couple of weeks before Christmas.

So a pretty similar cadence to what we saw in FY '20, although in FY '20, we did -- didn't have as much pull forward into October as we likely still have in this current year. So a more similar cadence to promotional events. I would expect holiday always to be promotional, and we are well positioned to be promotional and still maintain a great profitable story for our investors. So overall, I think we're in a great spot.

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

And just to be explicit, what we actually had said the promo environment was as expected. It was in line with our expectations in Q3. And you can imagine we're kind of taking -- what we're seeing and pushing that into Q4, but it hasn't been wildly outside our expectations.

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**Michael Allen Baker** - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Got it. Okay. If I could ask one more, and maybe you can't answer this, but you did talk a lot about some crowding out in that kind of dynamic with the higher inflation. Well, now all of a sudden, the inflation concern is turning to deflation concern. Asking you to look into your crystal ball, how that could impact your sales results next year if the inflation goes away and we're more in a deflationary environment?

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

Yes. I mean we've been pretty consistent as we've talked about the effects of inflation, we've been pretty consistent in saying, where it's putting pressure on the consumer is because it's in those key basic areas of need: fuel, food, lodging, consumables like the stuff you just kind of need every single day.

And that's what's been eating into a lot of that pent-up savings, especially for some of the lower income demographics. And so if you start to get into a world where you see more disinflation in some of those areas, then as you would expect, you start to free up some of that share of wallet for potentially getting back into goods or some of the kind of higher ticket purchases.

And so we're watching that carefully. Right now, still very elevated versus especially pre-pandemic, slowing down, and to your point, people start to talk about it, which over time, I think, could present some opportunity for people to move back into the goods space. Also, of course, depending on how elevated that spend remains around services and things like vacations and spending outside the home.

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**Operator**

Your next question comes from the line of Steven Zaccone of Citi.

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

I wanted to ask a question on average selling prices. So it sounds like it was flat, slight improvement. What drove that improvement on a sequential basis by category? And then as you think about the fourth quarter, can you talk about your outlook for units versus ASPs?

**Matthew M. Bilunas** - Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO

Yes. I we'll get into the -- by category improvement to ASPs. Generally speaking, we are starting to, I would say, lap some of the ASP reduction. We've been seeing ASPs slowly get lower, also the last number of quarters. I think we're starting to lap some of that deflation in that average selling price, if you will.

So I think it's probably as much as that as people are gravitating to in some cases, we mentioned that TV is an area of trade down that we are actually seeing. And so those do tend to lower your ASPs because it's a big ticket item. And as we start to lap that, I think you're starting to see some relief on the ASP sequentially.

Again, I think in certain areas, so in terms of like Q4, clearly, we've been seeing unit pressure overall, but there are some areas where some of our bigger categories we are expecting the units to improve. We're expecting TV units to increase. We're expecting to see improvements in notebook units as well. So it's a little bit varied, but those are some of the bigger ones.

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

Okay. Great. And then Corie, I had a question. Just thinking about next year, I think you alluded to more stabilization and the potential for growth in the back half, I guess I was curious, how do you see the recovery playing out?

We're waiting for the tech refresh cycle. But if the overall promotional environment stays challenging, how do you think about the recovery from market share position or maybe if the consumer is willing to trade down, how are you positioned to outpace the industry overall?

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

So if I think about how the last year has played out, this industry has largely been in a very promotional stance for over the last year. We've been pretty consistent in saying promos are back to, if not greater, than FY '20 levels. So this is not a new phenomenon for us. So even as we head into next year, we're lapping that. And even in that environment where you've seen that level of promotionality, as Matt said, we've sustained our share position.

So I think the team has done a beautiful job positioning us well in a very promotional environment. And I wouldn't be surprised to see that environment continue into the first part of next year. And again, we're lapping that kind of similar environment last year. So it's not a huge change in trajectory for us. I think what starts to make the back half, in our view, potentially more interesting next year is really a function of the innovation cycles.

And we can start to see a line of sight toward even read a little bit about, especially on some of the computing and processing side, devices that might start to feed into that as we head into the back half of next year. And back to Peter's earlier question, we can start to see on the horizon, some of that newness and innovation really on the docket as you head into the back half and into holiday for next year as everyone again, it's pretty incented to want to bring some vitality back to the industry.

**Operator**

Your next question comes from the line of Jonathan Matuszewski of Jefferies.

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

First one is on the competitive landscape. So you held market share in 3Q, and that's consistent with your comments in the first half. Obviously, you guys have superior customer service and assortment. So what's driving the success among competitors in the industry who you're tracking who are taking share? Is it purely a function of price? And how is that informing your pricing strategy over the next couple of quarters?

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

Again, I'm probably biased, but I don't think it's purely a function of price. I think we've been very clear, we have to be price competitive, and that is one of the base tent poles of our strategy. And that said, we also, I think, have a team that has a proven track record of very adept promotional planning around key drive times, whether that's some of the secondary holidays or whether it's the main holiday that we're headed into.

So I kind of think of price as the like primary tent pool. But in order to differentiate, I think what we're doubling down on is what we do, that is different than anyone else just given who we are. We are agnostic to the customer. So we don't care what the operating system is or who makes the hardware.

We're there for the customer to help them to build on that. We have what we like to call human-enabled services. So we can help you in the store. We can consult for you in your home. We can repair. We can take back. We can trade in. You can buy open box. You can go to an outlet. Like we just have the huge end-to-end variety of solutions all the way from inspire to support, so that's the kind of second differentiator for us.

And then third, I think we're building on those things with a unique membership program with unique offers that reach out to our members with a membership program that's based on the things that we uniquely do well.

And then fourth, I have to give major credit to our vendor partners as well, even though we're in a little bit of a slower innovation cycle, they remain clearly committed to our success, which means we do have everything from the most new beautiful 98-inch TV that's out on the floor, all the way to those opening price point -- Chrome books or opening price point televisions that might be right for you at a value play.

And I think our ability to showcase those high and new experience as well as all the way through the rest of the assortment really is that last differentiating piece for us.

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

That's great color. And then a quick follow-up on Best Buy Health. You've had some exciting announcements on that side of the business in terms of partnerships in the industry. At the Investor Day, I think you called out expectations for that to grow at a CAGR of an impressive 40% over the next couple of years. Is that business at scale to switch from kind of dilution to accretion in terms of the overall enterprise next year? Any thoughts there would be helpful.

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

Yes. So we remain really excited about the health business, and we were pretty clear that we had pulled the FY '25 targets on the whole or as the macro backdrop has changed. And so we are, of course, working behind the scenes to really fortify that business for the future.

And I know someone had asked earlier as we think about the puts and takes for next year, we would continue to expect Health to become more accretive, and we laid that out as kind of our structural thesis at our Investor Day. And that part of the thesis remains true for us. And while it still is relatively small at this point, we are seeing some nice uptick, particularly in that kind of care-at-home side of things, where we've announced partnerships with Geisinger and with Atrium Health as we think about how we can use our unique e-Quad assets as a unique product assortment that we have help deliver care at home.



So again, relatively small, but the team is doing a nice job continuing to ensure that, that part of the business is accretive and grows over time.

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**Operator**

Your next question comes from the line of Steven Forbes of Guggenheim.

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

Matt, you briefly mentioned 15 to 20 basis points of vendor funding being recorded in expenses. Curious if you can maybe give us a little more color there? And then any sort of different way of thinking about how vendor funding maybe supports the margin outlook for 2024? Or are you changing the 2024 margin color of being able to hold margin in a flat sales environment, any update there?

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**Matthew M. Bilunas** - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Sure. Yes. So first of all, it was \$15 million to \$20 million of impact on net basis points, just to make sure I'm clear. And that would carry on as you get into next quarter Q4 and the first part of next year. And this is strictly a geography. There is no change to the overall financial statements, if you will, just moving as a cost -- offsetting a cost of sales to offsetting SG&A.

Essentially, being any number of types of vendor funding for a number of different things in one week and actually be more specific with the funding, matching and offsetting the specific cost, we then record that as an offset to SG&A versus offsetting cost of sales. So that's specifically what's happened. And it's just -- it's part of the funding that we get not all of it, obviously.

And so we would expect that to continue. To your second question, as you look at next year, at this point, we're not guiding next year, but we would expect product margins to be somewhat of a neutral impact to next year. Overall, we don't, at this point, see a lot of material changes either way. We have a very strong relationship with our vendors, and they are obviously as interested in us in stimulating sales and showcasing their products and innovations that they have. So at this point, we don't see any change to that as we look into next year.

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

Matt hit on this, but I want to underscore the way in which our vendors participate with us varies as you would expect, depending on what we're seeing in the macro. Sometimes that shows up as more promotional partnership. But a lot of times, that shows up in very different ways it can be in how we think about specialized labor, it can be in store experiences like we mentioned on the call. It can be in our Best Buy ads business or in supply chain fulfillment or in services. .

And I think what's important is our overall level of invested support has grown in the aggregate even as we compare it to pre-pandemic levels. And I think that is the part that for us as important is how can we be the very best partner to our vendors as we collectively want to bring, especially some of this newer innovation to market.

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

Maybe just a quick follow-up for you, Corie. Any updated thoughts on maybe some of your newer growth initiatives such as device life cycle management, really just trying to think through whether the current sort of operating performance or challenges that are out there are impacting the investments you plan to put behind some of these initiatives? Or whether that's still sort of a growth sort of plan for next year?

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

Yes. As it relates you hit on specifically device life cycle management, I'm maybe going to take it up one level and that, as we've talked about it as a Service, because it can be everything from device cycle management, which is newer side of this, but also just providing service on behalf of vendors as you think about being an Apple authorized service provider or some of our Best Buy business offerings where we actually use our service profile to go out and do installations writ large.

What's nice about an initiative like this, is it doesn't require, especially in the earlier stages, much incremental investment. We already have Geek Squad City, which is a very large facility, well staffed, with trained experts who we can leverage some of their capacity in order to deliver on something like device life cycle management.

Now then we can make decisions as something like that ramps. We didn't mention it this quarter because in Q4, honestly, it's not the biggest front and center area of focus. But you can also imagine behind the scenes, if there are other ways for us to leverage our existing expertise and capacity.

Those are very interesting strategic initiatives for us. And we remain excited about this one. We remain excited about the pipeline that we're seeing in this one. And obviously, I think you can expect that we will update you with more clarity as it develops.

So with that, I think that is our last question, and I want to thank you all for joining us today. Thank you for the nice wishes. I hope you all also have a wonderful holiday, and we look forward to updating you all on our results and progress during our next call in February. Thank you, and have a great day.

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**Operator**

This concludes today's conference call. You may now disconnect.

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