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BBY.N - Q4 2023 Best Buy Co Inc Earnings Call

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OVERVIEW:

Co. reported 4Q23 enterprise revenue of \$14.7b and non-GAAP diluted EPS of \$2.61. Expects FY24 enterprise revenue to be \$43.8-45.2b and non-GAAP diluted EPS to be \$5.70-6.50.

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PRESENTATION

Operator

Hello, and welcome to the Q4 Full Year '23 Earnings Call. My name is Francois, and I will be your coordinator for today's event. Please note this conference is being recorded. (Operator Instructions) I will now hand you over to your host, Mollie O'Brien, to begin today's conference. Thank you.

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 non-GAAP financial measures are useful, can be found in this morning's earnings release, which is available on our website, 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.

Later today, we will post a third-party transcript of this call to our Investor Relations website as well as a financial recap slide presentation.

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 Q4 sales results in line with our expectations and better-than-expected profitability. We knew customers would be looking for joy during the holiday but would also be seeking great value given the pressures of inflation. Consumers responded to our compelling deals, and as we predicted, their shopping patterns were more similar to historical holiday periods than what we saw the last 2 years. Specifically, customer shopping activity was more concentrated on Black Friday week, Cyber Monday and the last 2

weeks of December than last year. Customers continue to choose us for the expertise, service and overall value we provide across all channels. Our customer satisfaction scores indicate that our talented teams and omnichannel capabilities delivered better experiences during the critical holiday period this year compared to both last year and the prepandemic fourth quarter of fiscal '20, especially within our services and delivery experiences.

Throughout the quarter, we were committed to balancing our near-term response to current conditions and managing well what is in our control, while also advancing our strategic initiatives and investing in areas important for our long-term performance. Each and every day, our management team and employees across the company are making tough trade-off decisions. Our Q4 comparable sales were down 9.3% on a year-over-year basis. Our non-GAAP operating income rate of 4.8% was higher than expected. The promotional environment in the fourth quarter was more intense than last year. However, the related financial pressure was less than expected and contributed to a stronger gross profit rate performance.

As a reminder, we first began to see promotional activity return in the back half of calendar 2021. Since then, it has proliferated across categories, and we would characterize the promotional environment for consumer electronics as essentially normalized back to prepandemic 2019 at this point.

We continue to manage our inventory very effectively and are focused on maintaining targeted weeks of supply that we believe are appropriate for the current business trends. Our inventory at the end of Q4 was down 14% from the fourth quarter of last year and is essentially in line with our sales trajectory versus prepandemic fiscal '20. From a merchandising perspective, the largest impacts to our domestic comparable sales decline came from computing, home theater, appliances and mobile phones, partially offset by growth in gaming and tablets.

Our organics were similar to last quarter with our blended average selling price, or ASP, down low single digits on a year-over-year basis. ASPs will likely continue to be lower on a year-over-year basis as we start the year until we lap the full return of promotional activity that occurred in the second half of last year. Compared to fiscal '20, ASPs continue to be quite a bit higher, and we believe they will likely remain higher going forward. As we've shared previously, this is due to category mix with the growth of higher ASP appliances and large TVs as well as more mix into premium products at higher price points.

I am proud of our team's execution and their relentless focus on providing amazing service to our customers, while also managing the business for future growth, during what continues to be a challenging environment for our industry.

As we enter fiscal 2024, macroeconomic headwinds will likely result in continued volatility, and we are preparing for another down year for the CE industry. We are expecting the most comparable sales pressure in the first quarter as year-over-year compares ease through the year. Based on what we can see right now, we believe that calendar 2023 will be the bottom for the decline in tech demand. There are several factors driving the expected return of industry growth, which could occur next year depending on the macro environment. First, we continue to see evidence that much of the growth during the pandemic was incremental, creating a larger installed base of technology products and consumers' health. On average, U.S. households now have twice as many connected devices as they did in 2019. And consumers indicate that more of their tech purchases are need-based than want based.

For example, in our recent surveys, the majority of consumers indicated that most tech purchases are for functional reasons versus emotional ones. Second, we will start to see the benefit of the natural upgrade and replacement cycles for the tech [bot] early when the pandemic kick in, possibly later this year, depending on the macro environment, even more likely in calendar 2024 and 2025. Historically, customers upgrade or replace their tech every 3 to 7 years depending on the category, with mobile phones on the lower end, computing in the middle and home theater and large appliances towards the higher end of that range.

Third, this is not a static industry. Billions of dollars of R&D spend by some of the world's largest companies and likely sum we haven't even heard of yet, means innovation is constant, driving interest, upgrades and experimentation. That innovation has largely been paused since the pandemic began and the focus shifted to production. And we believe there will be a desire from our vendor partners to stimulate those replacement cycles or build completely new categories going forward.

Additionally, there are several macro trends that we believe should drive opportunities in our business over time. For example, cloud and augmented reality will increasingly lead to new capabilities and customer experiences. The cloud solves significant customer pain points by making it much

easier and faster to transfer your data and existing device preferences to the next generation of product, which creates customer interest in upgrading more frequently.

In the augmented reality space, we believe significant developments are coming that will generate dramatic change in many products over time. Also, the recent government infrastructure funding allocated to expand broadband Internet access to more Americans provides additional support for these macro trends and incremental access to broadband is proven to help fuel tech demand. And as we noted, since the beginning of the pandemic, the vendor community has been more focused on making product rather than refreshing product. And we believe the industry will get back to more of a normalized pace of meaningful innovation towards the end of calendar 2023 and into 2024.

Specific innovation we expect to see this year in our larger product categories include dual-screen and foldable laptops in computing and personalization in large appliances. In home theater, beyond traditional panel innovation, we're seeing more of a lifestyle type approach to innovation. For example, there's growing popularity of new high-performance audio and video products, including TVs, projectors and speakers that more seamlessly blend into a room versus older technology that takes up a substantially larger physical footprint in the home.

While all our product categories have slightly different timing nuances, in general, they are poised for growth in the coming years. In addition, we are continuing our expansion into newer categories like wellness technology, personal electric transportation, outdoor living and electric car charging. We are the CE experts and the best place for customers to see existing and new tech and get advice and support.

In our August 2020 earnings call, during the first year of the pandemic, we said we believed customer shopping behavior would be permanently changed in a way that is even more digital and puts the customer entirely in control to shop how they want. And our strategy was to embrace that reality and to lead, not follow. With that as a backdrop, we are building out our suite of unique assets that deliver customer experiences no one else can, and that we believe makes us the compelling retailer of the future.

As we do this, we are carefully balancing our short- and long-term initiatives given the volatile environment. There are 5 main areas we are strategically focused on. We will not dive deeply into all of them today: one, evolving our omnichannel retail model; two, building customer relationships through membership; three, incubating and growing Best Buy Health; four, removing costs and improving efficiency and effectiveness; and five, unlocking reverse secondary market opportunities.

I will now provide more detail on the evolution of our omnichannel retail map. In fiscal '23, digital sales comprised 33% of our domestic revenue compared to 19% in fiscal 2020. Sales via phone, chat and virtual have also remained significantly higher. Even with that shift, our stores remain a cornerstone of our differentiation. Not only it's 67% of our domestic revenue transacted in our stores, more than half of our identified customers engage in cross-channel shopping experiences.

And of course, more than 40% of online sales are picked up in stores. Further, we play an incredibly important role for our vendors as the only national CE specialty retailer who can showcase their products and help commercialize their new technology. We were already a leading omnichannel retailer heading into the pandemic. However, we knew that in order to stay relevant in an increasingly digital age, we needed to evolve our omnichannel retail model strategy. And within that, our portfolio of stores needed to provide customers with differentiated experiences and multichannel fulfillment.

We also needed them to become more cost efficient to operate while remaining a great place to work. Over the past 3 years, we have been optimizing our store staffing model to reflect the changes in customer shopping behavior and to fuel investments in higher wages. We have also been rapidly testing different store formats and operating models.

During those 3 years, we closed approximately 70 large format stores, or 7%, including 17 closing this week through our normal stringent lease review process. At the same time, we opened 4 new stores, including new smaller store formats and relocated 6 stores. In addition, we completed 44 remodels to our 35,000 square foot experienced store format. Finally, we boosted our technology development and our digital tools, including our app, to drive customer satisfaction, employee satisfaction and increased efficiency in our stores.

Now I would like to provide our high-level plans to refresh our U.S. store portfolio over the long term. We will continue to close an average of 15 to 20 traditional large-format stores per year through our normal lease review process. We will also continue to scale our experienced store remodels. As we have shared previously, this format has more premium experiences in a 35,000-square-foot selling area, showcasing the very best of Best Buy.

We will decrease the selling square footage and adjust the assortment and merchandising strategy in many of our stores. The shift to digital sales and the resulting lower in-store revenue, in addition to a much larger percent of high ASP appliances sales, has pressured our operating model and working capital. For context, roughly 80% of the SKUs we display on our sales floor sell one or fewer per week. In these core medium-sized stores, some of the selling square footage will be shifted into larger backrooms. So the total square footage of these stores is not expected to change materially. Our stores have multiple purposes now, and a larger backroom provides better support for other capabilities like our high rate of in-store pickup of online orders.

In addition, we see significant opportunity to leverage these larger store warehouses and our supply chain expertise to help our vendor community fulfill a larger portion of their direct-to-consumer channel. In addition, we will open more outlet stores that support our value-focused customers. These stores are driving a higher mix of new and reengaged customers in addition to a better financial recovery on open box and return product.

Over time, we believe we can also leverage these outlet locations to help our vendor community with their own open box and refurbished goods that are coming from other channels. As it relates to our small format pilots that focus on tech Essentials, we will continue to monitor them to determine the go-forward plan. We believe there is an opportunity for these to be growth vehicles in underserved urban neighborhoods as well as small remote markets. We're utilizing a market-based approach to evolve our stores. This means we're moving away from a one-size-fits-all model to a portfolio comprised of store formats and fulfillment solutions appropriately sized and working together to efficiently serve our market.

From a timing perspective, as you would expect, we're going to phase these changes in line with how the business evolves. We view our store portfolio evolution as a long-range rolling plan, continually making adjustments each year with a sustainable annual investment over time. For fiscal '24 specifically, our plans include closing 20 to 30 large format stores, implementing 8 experienced store remodels and opening around 10 additional outlet stores. In addition, we plan to complete 2 remodels of our medium core format.

We expect to incur approximately \$200 million in capital expenditures for both these physical store changes and routine store resets and maintenance. This is down approximately \$100 million from last year. Of course, at the same time, we will continue to evolve our operating model to match the lower selling square footage and the ongoing evolution of our business model. Over the past 3 years, our overall head count has declined by approximately 25,000 people, or 20%, as we adapted to the shift in customer shopping behavior and in the effort to drive more flexibility.

Our most recent restructuring activities will allow us to invest more in our customer-facing labor and at the same time, drive increased ability to flex labor spend with revenue fluctuations. Stepping back, we expect the evolution of our store portfolio and operating model to drive sales lift and efficiencies over time. Most importantly, these changes are necessary to relieve the pressures of a changing world, a world in which customers are in control and increasingly more digital and the cost to operate physical stores such as rent and labor are not likely going to come down.

Now I'd like to talk about membership and its role in driving deeper relationships with our customers. As we said last quarter, in fiscal 2024, we will continue to iterate our programs based on the macro environment and what is most relevant to our customers. I'll start with an update on our entry tier of membership, my Best Buy program. For context, we have approximately 100 million members, with 40 million to 45 million members active per year.

My Best Buy has long been a points-based loyalty program. The efficacy of points programs has been declining over time as we analyze the data and talk to our customers, we found free shipping resonated even more than 1% back on their purchases. As a result, earlier this year, we added free shipping for all purchases with no minimum purchase. At the same time, we transitioned the ability to earn points solely to purchases made on our co-branded credit cards.

Our credit card members will continue to earn 5% back in rewards on their purchases at Best Buy in addition to flexible financing options. Thus far, feedback indicates that the changes are resonating with our customers. Moving on to TotalTech, our comprehensive paid membership that includes

24/7 technical support, product protection for all your tech products, special member pricing and much more. We launched it, knowing it was a bold new membership program, unlike anything else in the retail industry.

Our investment thesis remains very much intact. Members are engaging more frequently with us, shifting their tech spending to Best Buy and buying more cross-category than nonmembers. Additionally, members continue to rate our experiences higher. Our Net Promoter Scores from TotalTech members remain considerably higher than nonmembers. Like we did with My Best Buy, we have been studying these customers closely in the first year of the program to really understand what drives not just acquisition, but engagement with us.

We're going to use that data to evolve our membership proposition. For example, we will tailor the offer with the intention of retaining customers at increasingly higher levels, and, at the same time, explore a tiered approach that may resonate with an even bigger population of customers.

We mentioned on our November call that we plan to iterate in ways that reduce the cost to serve, and we're leveraging member usage and retention data to do so. We've made 2 small changes already with more planned this year. These 2 changes were adding back restocking fees for certain product returns and removing free same-day delivery as a benefit.

From a financial perspective, we lapped the financial pressure from the initial investment impact late in Q3, and the program had a neutral year-over-year impact on Q4. We expect membership to contribute to operating income rate expansion from here as the program continues to build and we iterate on the offering. In fiscal '24 specifically, we expect our membership program changes, including My Best Buy changes, to drive approximately 25 basis points of enterprise operating income rate expansion, which will primarily be in the back half of the year. We expect to share more details on the coming plan changes on our May call.

Transitioning to Best Buy Health. The role of technology within healthcare is becoming more important than ever, and our strategy is to enable care at home for everyone. In fiscal '24, we expect to grow Best Buy Health sales faster than the base business. We also expect to drive a higher mix of our more profitable and unique service plans and deliver cost optimization in our active aging business.

We expect these initiatives to drive approximately 10 basis points of enterprise operating income rate expansion. I want to spend a few minutes on our Care at Home solution that leverages current health, our leading technology platform that brings together remote patient monitoring, telehealth, a full support model and patient engagement into a single solution for health care providers and pharmaceutical companies.

Boosted by its affiliation with Best Buy, Current Health had its best commercial booking year ever last year, and we now have relationships with 5 of the top 10 largest health systems in the U.S. These names include Geisinger, Mount Sinai Health System, NYU Langone Health and others. 40% of our provider clients launched in Q4, demonstrating our momentum.

We also just began a 3-year development partnership with Advocate Health. This partnership will leverage Advocate Health's nationally leading hospital-at-home-program, providing care to a population of over 6 million people and Best Buy's technology expertise. Together, we will develop enhanced capabilities and better patient experiences for both Advocate Health and other health systems around the [company.] We are excited about the momentum of Care at Home, but it is still a nascent emerging part of the healthcare industry.

We are essentially nurturing a startup within a large-scale organization and leveraging Best Buy's core assets, including the Geek Squad to incubate a new business. The revenue contribution is currently very small and will take time to ramp as the Care at Home space matures and expands over the coming years.

Before turning the call over to Matt, I would like to provide a few updates on our commitment to our employees and communities we serve. We know our employees and the expert service they provide are our core competitive differentiator, and we are maniacally focused on driving positive employee experience and engagement. Of course, the competitive compensation continues to be table stakes, and we've increased our store associate hourly pay approximately 25% in the last 3 years.

Additionally, external research supports our belief that employees are increasingly prioritizing human factors of their jobs, including well-being, work life balance, career development and culture, our unique way of managing our portfolio of employee benefits coupled with the intentional

approach to provide ladder and lattice career movement at all levels helps counteract the market pressures of rising wage rates in retail. We serve customers in a multitude of ways, in store, in home and virtually, providing many opportunities for employees to upskill and reskill and ultimately choose the path that's right for them at Best Buy.

60% of our general managers started at Best Buy in non-leadership role, and 94% of our general managers and assistant managers here today were hired internally. We are gratified that our employee retention rates continue to outperform the retail industry.

From a community standpoint, we finished the year with 52 Best Buy team tech centers and are well on our way to accomplishing our goal of 100. These centers continue to provide young people in our communities with the access, inspiration and opportunity they deserve to help them define their futures. I am proud to say that Best Buy continues to be recognized for the many ways we are supporting our employees and communities. In Q4, we ranked 34th and were the #1 retailer on the Just Capital list that evaluates and ranks the largest publicly traded companies in the U.S. in part on how a company invests in its workers, supports its communities and minimizes environmental impact.

In summary, we believe the macro and industry backdrop will continue to be volatile this year. We have a proven track record of navigating well through dynamic and challenging environments, and we will continue to adjust as the macro evolves. At the same time, we remain incredibly excited about our future. We believe our differentiated abilities and ongoing investments in our business will drive compelling financial returns over time, and we are carefully balancing our reaction to the current environment with focus on our strategic initiatives.

The structural hypothesis we laid out in our investor update last year remains true. There are more technology products than ever in people's home. Technology is increasingly a necessity in our lives, and we uniquely are there for our customers as they continue to navigate this innovative space. We are in this for the long term and believe our purpose to enrich lives through technology is only more relevant in the future.

I will now turn the call over to Matt for more details on our fourth quarter financials and fiscal '24 outlook.

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

Good morning, everyone. Let me start by sharing details on our fourth quarter results. Enterprise revenue of \$14.7 billion, declined 9.3% on a comparable basis. Our non-GAAP operating income rate of 4.8%, declined 30 basis points compared to last year, which is an improvement from previous trends as this was the first full quarter of lapping the rollout of our TotalTech membership offering. Non-GAAP SG&A was \$241 million lower than last year and increased approximately 10 basis points as a percentage of revenue. Compared to last year, our non-GAAP diluted earnings per share of \$2.61, decreased 4%. The year-over-year decline in our earnings per share was driven by the lower operating income dollars I just mentioned, which were partially offset by a \$0.19 per share benefit from a lower share count, a \$0.06 per share benefit from higher interest income and a \$0.05 per share benefit from a lower effective tax rate.

While our sales results were down to last year, overall, they aligned very closely with our expectations entering the quarter, including our assumptions on the monthly phasing and the mix of revenue by channel. Our non-GAAP operating income performance exceeded our expectations due to the higher gross profit rate, which included slightly less pressure from promotions than we had expected.

Next, I will walk through the details on our fourth quarter results compared to last year. In our Domestic segment, revenue decreased 9.8% to \$13.5 billion, driven by a comparable sales decline of 9.6%. Online revenue of 38% of our total domestic revenue, which was 12th consecutive quarter that our online sales mix was above 30%.

As expected, December comparable sales decline of approximately 8% was our best performing month on a year-over-year basis. When comparing to the prepandemic fiscal '20 comparable period, January was our best performing month and the only fiscal month that had positive growth. Our domestic gross profit rate declined 20 basis points, primarily due to lower product margin rates, which were partially offset by favorable service margin rates and the higher profit-sharing revenue from our credit card arrangement.

The improved service margin rate included a favorable \$30 million profit-sharing benefit from our services plan portfolio. Domestic non-GAAP SG&A declined \$224 million on lower store payroll cost, reduced incentive compensation and lower advertising expense. Incentive compensation

was favorable to last year by approximately \$90 million this quarter and \$455 million year-to-date. Our store payroll expense was once again favorable to last year, both in dollars and as a percentage of sales.

Next, let me spend a few moments on restructuring. In light of ongoing changes in our business trends, earlier in fiscal '23, we commenced an enterprise-wide restructuring initiative to better align our spending with critical strategies and operations as well as to optimize our cost structure. We incurred \$86 million of such restructuring costs in the fourth quarter and \$147 million year-to-date, which primarily related to employee termination benefits. Since we started our Renew Blue transformation 10 years ago, we have been committed to leveraging cost reductions and efficiencies to help offset investments and pressures in our business. Our current target set in 2019 was to achieve an additional \$1 billion in annualized cost reductions and efficiencies by the end of fiscal '25.

During fiscal '23, we reached our \$1 billion target. These efforts highlight how we have been adjusting our cost structure to navigate the dramatic changes in our business while balancing the need to invest in our initiatives. Savings from these initiatives are being used to help offset higher labor costs, depreciation and the add-back of incentive compensation.

Moving to the balance sheet. We ended the quarter with \$1.9 billion in cash. As Corie mentioned, our year-end inventory balance was approximately 14% lower than last year's comparable period, and we continue to feel good about our overall inventory position as well as the health of our inventory. During fiscal '23, we returned \$1.8 billion to shareholders through share repurchases and dividends. We remain committed to being a premium dividend payer. This morning, we announced that we are increasing our quarterly dividend to \$0.92 per share, which is a 5% increase. This increase represents the tenth straight year of raising our regular quarterly dividend. After pausing share repurchases earlier this year, we resumed in November and ended the year with \$1 billion in repurchases.

During fiscal '23, our total capital expenditures were \$930 million versus \$737 million in the prior year, mainly due to increased store-related investments. Looking to fiscal '24, as Corie discussed, store-related investments are planned to decrease approximately \$100 million compared to fiscal '23.

Let me next share more color on our outlook for fiscal '24, starting with the 53rd week that will occur in the fourth quarter. We expect the extra week in fiscal '24 to add approximately \$700 million in revenue and provide a benefit to our full year non-GAAP operating income rate of approximately 10 basis points. The higher operating income rate is primarily driven by the added leverage on SG&A for items such as occupancy and depreciation, which are not impacted by the extra week. As a reminder, the revenue from the extra week is excluded from our comparable sales.

Moving on to our full year fiscal '24 financial guidance, which is the following: Enterprise revenue in the range of \$43.8 billion to \$45.2 billion, Enterprise comparable sales of down 3% to down 6%, Enterprise non-GAAP operating income rate in the range of 3.7% to 4.1%, a non-GAAP effective tax rate of approximately 24.5%, non-GAAP diluted earnings per share of \$5.70 to \$6.50. In addition, we expect capital expenditures of approximately \$850 million. We expect to repurchase shares during fiscal '24, however, we are not providing a target today. We will continue to assess our overall working capital needs and provide updates as we progress throughout the year.

Lastly, we expect interest income to exceed interest expense this year.

Next, I will cover some of the key working assumptions that support our guidance, starting with our top line outlook. As we enter the new fiscal year, the consumer electronics industry continues to feel the effects of a broader macro environment. At the high end of our guidance range, we expect comparable sales to be approximately flat as we exit the year. The low end of our guide reflects a scenario where the consumer spending regresses even further from our current levels and lasts longer into the year.

Moving next to profitability. Our non-GAAP operating income rate is expected to decline next year due to the SG&A leverage on expected sales decline. We are expecting to drive gross profit rate expansion of 40 to 70 basis points compared to fiscal '23 due to the following actions and initiatives.

First, as Corie discussed, the planned changes to our membership offerings are expected to improve our gross profit rate by approximately 25 basis points. Second, we expect to see benefits from optimization efforts across multiple areas, including reverse supply chain, large product fulfillment

and our omnichannel operations. Third, continued growth in Best Buy Health is also expected to contribute to gross profit rate expansion. Lastly, we expect the impacts from promotions, supply chain costs and the profit sharing from our private label credit card to have a neutral impact to our annual gross profit rate compared to this past year.

Now moving to SG&A expectations. We expect SG&A as a percentage of sales to increase approximately 100 basis points compared to fiscal '23. As we have shared in prior quarters, we expect higher incentive compensation as we reset our performance targets for the new year. The high end of our guidance assumes incentive compensation increases by approximately \$225 million compared to fiscal '23. Depreciation expense is expected to increase by approximately \$50 million. Store payroll expense, which includes continued investments in store wages, is expected to be approximately flat to fiscal '23 as a percentage of sales.

Lastly, as you would expect, our guidance reflects our plans to further reduce our variable expenses to align with sales trends.

Before I close, let me share a couple of comments specific to the first quarter. We anticipate that our first quarter comparable sales will decline approximately 10%, which is similar to our revenue trends during the first 4 weeks of the quarter. We expect our operating income rate to decline at the lower -- as the lower revenue delevers on SG&A dollars that are similar to last year. We expect our gross profit rate to improve compared to last year, with the expansion slightly below the full year outlook I just shared.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first caller, please go ahead. First caller, please ask your question.

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

It's Michael Lasser from UBS. Corie, you're making all these changes, it seems like in response just to the evolution of the business where, prior to the pandemic, e-commerce penetration was 20%. Now, it's in the 30% range and that inherently changes the profitability of the Enterprise. So the question is, how do you balance maintaining a strong customer experience, while trying to restore the overall margin level back to where it was prior to the pandemic?

And how much customer erosion and sales erosion are you anticipating this year with all the changes that you're making to some of the membership programs?

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

So the purpose of the changes we're making is, first and foremost, to meet a changing customer. And that's why my -- I led even in my remarks around the measurement of our customer experiences and how across the board in Q4, we have actually continued to see improvement in NPS and the measurement of those experiences. The primary goal, of course, is to create customer experiences that people love. And when they want to come to the store, to meet their needs in the moment, sometimes -- and this is part of what's changed. Sometimes that is I want very rapid fulfillment of my product. I want to pick up in store and have the confidence of grabbing that product.

Sometimes that is, "I want a deeper, more immersive experience." And what we're learning our way through it is part of why we've done piloting and testing, and we're taking a long time to make changes, or what sometimes we get feedback seems like a long time to make changes is because we want to give this enough room to breathe, to make sure we feel like we're not eroding the customer experience. It's why we are investing more in our frontline associates, who are the ones who are right there meeting the customer in the moment.

And so our priority is not just the cost side. Our priority is actually what does the experience of the future need to look like so that we meet the customer expectations, and we hold ourselves very accountable to the measurement of those experiences.

On the membership side -- and we talked about it a little bit in the prepared remarks, what we're trying to figure out is the balance between acquisition of members but also retention of members. And what are those experiences, again, that really keep customers sticky? I mean the whole point of a great membership program is that you remain relevant to your customer base. And now -- I mean it's only been a year. And again, we have relatively low frequency with our customers. And so we're just getting data around what is it that keeps someone frequently enacting with Best Buy. And so it's changes to TotalTech but I think you heard us also mention in there, we see the opportunity potentially for another tier that might be a little bit more value-oriented, might be a little bit more convenience-oriented, but might have broader appeal.

And so I think what we're trying to do is, that's why we also brought my Best Buy into the conversation, we're looking across the entire gamut of what we think we can provide our customers and see the opportunity for a tiered approach all the way from free where you get free shipping, which is really resonating, all the way up to a very comprehensive membership program like TotalTech where you get everything around support. So the goal here, Mike, at the end of the day is to deliver the best possible customer experiences that are important in a new world where a customer is shopping differently.

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

Okay. My follow-up question is, quarter-to-date, you're trending down 10%. You are expecting within the guidance to be flat by the end of the year. So is the progression from down 10% to flat, is that linear, so we should be expecting steady improvements over the course of the year? And what is -- what is that dependent on in terms of product introductions, execution and the competitive environment?

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

Thank you, Michael. As you said, our guide prudently assumes that inflation persists and the consumers are going -- be continued to make trade-offs around their spend. And so at a high end, the comps progressively improved throughout the year. And like I said, we will exit the year more on the flat to slightly possibly growing as the pressures in the CE industry kind of abate as we progress through the year. So maybe not perfectly linear, but we do expect that at the high end, the sales performance would progressively improve.

At the low end of the guide, we're clearly modeling a more sustained pressure on the CE industry as customers feel the longer effects of the macro pressures of inflation that continue to shift some spend to the activities in travel. So that's kind of the 2 ends of our expectations for next year. But again, at the high end, we do expect our sales and the industry itself to improve as the year progresses, which is consistent actually with what -- some external benchmarking you would look at between NPD and CTA, which would also expect some level of improvement.

Operator

Next caller, please, state your name and company name before asking your question.

Karen Fiona Short - *Crédit Suisse AG, Research Division - Research Analyst*

It's Karen Short from Credit Suisse. So I have 2 questions. I guess the first question is just, obviously, the midpoint of your sales guide is \$1 billion above calendar '19, but EBIT margins are 100 basis points below. So again, calendar '19, but promos seem to be likely consistent in '20 -- calendar '23 relative to 2019. So can you just elaborate on that a little bit?

And then with respect to the members that you called out, \$100 million is clearly a very strong number in terms of members for My Best Buy, TotalTech. Can you just give a little color on what percent of sales those members represent? And then maybe some color on how you could better leverage that program?

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

Sure. I'll start and then Corie can jump in too. I think the comparison you're talking about is this year compared to FY '20 -- or calendar 2019, if you think about our business -- for me the biggest change from this past year to 2019 is within gross margin in the 2 very big factors that have lower gross margin since that time are: one, supply chain costs that are much higher. Part of that is the online mix that has grown, and the other part of that would be supply chain inflation that hopefully, we would see abate over time.

The second biggest impact to gross margin has been our rollout of the membership offering, which, during the quarters last year, when we weren't fully lapped, it was almost 100 basis points of pressure compared on a year-over-year basis. So those are the biggest impacts compared to that 2019 period, which was gross margin...

SG&A was -- rate was rather similar to 2019. And so what you do have there is you have savings compared to store labor being down. And then you have offsetting that a bit is the investments we've been making in technology and depreciation coming through from higher capital.

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

On the membership side, let me make sure I clarify the numbers. We have about 100 million My Best Buy members, of which 40 million to 45 million are active. On the TotalTech side, we currently have 5.8 million members. That's compared to 4.6 million we had last year. So those are kind of the 2 pools of membership that we're talking about. And we haven't given the percent of sales of those members, but you can imagine, it's a fairly high percent of sales between those 2 membership pools.

I think we see a lot of opportunity to continue to engage with those members. As you can imagine, with a My Best Buy program that large, we know a lot about those customers. And we are able to tailor to those customers. We know even more about our TotalTech members, of course. And I think we see a future where we're able to tailor more direct opportunities, sales opportunities with them. We also can see potentially that if we look at a tiered approach, there's a whole another tranche of customers who might be interested in doing more with us and having a longer relationship with us.

And now as we're heading during the second year of TotalTech, we're learning a lot. We think we're going to drive more engagement through a more personalized approach. We're working on our onboarding process for new members so they really understand what's available to them. And we're leveraging some of our existing vehicles so that people understand everything that we do from consultations, all the way through services, all the way through trade-in and some of the other offers. And then, of course, this speeds into some of our Best Buy Ads model, where we can tailor our advertising to specific audiences based on what we know about them. So this pool of customers is really vital to us, and I think we are continuing to improve the way we engage with them, and also drive their engagement back with us.

Karen Fiona Short - *Crédit Suisse AG, Research Division - Research Analyst*

Any chance you could just tease out a renewal rates?

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

We haven't given renewals, and we're not going to. And as you can imagine -- I mean they've been relatively in line with our expectations. You can imagine, there are some places where we see much better engagement and renewals and people who engage in things like support or who value the warranty side of TotalTech as an example, they are very, very interested in renewing. And so I think that's -- when we talk about tailoring the program for the future, we're looking for those customers who find value in some of the more unique aspects of the program and stick with the program because they see the value in that.

Operator

Next caller, please go ahead.

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

It's Seth Sigman from Barclays. Nice to talk to you. My first question is just around pricing and the promotional environment. I think the point that you made is that Q4 actually ended up being a little bit less promotional. Can you just elaborate on that? And then as you think about this calendar year, it does seem like a lot of retailers are planning conservatively in this category. I guess what have you reflected here in the guidance for gross margin specifically related to discounting and promotional activity?

Matthew M. Bilunas - Best Buy Co., Inc. - Executive VP & CFO

Sure. Just to recap, in Q4, we did see product margin rates lower in Q4, driven by on a year-over-year basis of more promotionality. What we did see compared to expectations is actually a little less pressure from promotionality even though we were expecting it to be more promotional year-over-year. As we look into next year, our guide reflects, I think, it's -- one of my comments in prepared remarks was the combination of product margin rates, [city] profit share and supply chain, we're going to be pretty neutral to the whole year. That doesn't mean that in some quarters, it might be a little better, a little worse. But for the most part, next year, we're assuming that it's a fairly neutral impact of [a broad] promotionality, not that some quarters might also be more promotional from a pricing perspective, the impact of that promotionality might not actually manifest in the financial pressure.

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

Okay. And then I guess, just thinking about demand in general, there's obviously a few factors battling each other here. There's a lot of consumer noise. You also have pull forward in your category. You talked about replacement cycles. I guess I'm just trying to think about elasticity as you start to see ASPs come down, and we can't really see it on a category level, we only see it in aggregate. But are there any signs of maybe elasticity starting to kick in here? Just curious how you're thinking about that.

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

Yes. I think you started with what makes the conversation a little bit difficult, which is the incredibly varied indicator that are out there with the consumer right now, right? Everything from historically strong job markets, spending continues specifically on services even more so than goods. Inflation might be slowing, but it still is sustainably high.

And it's high in some of the basics like food, fuel and lodging, right? And when the basics are where that sustainable inflation is, it does mean the customer is going to make trade-off decisions. And I think we've used the same language now for probably 3 quarters. You've got an uneven and unsettled consumer who, from a confidence perspective looking forward, is still not confident about the future. And so I think what we are trying to position ourselves for is the best possible value for that consumer when they're ready in the moment. And I feel like in Q4, I think we've played that very well.

Our pricing was very competitive. Our price perception was very competitive. And so you can see in spot as there is a better deal to be had, you can see the consumer reacting. But no matter what, it's against this overlay of a consumer who's going to make trade-off decisions based on their own budget and their own life.

Operator

Next caller, please go ahead.

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

It's Steven Forbes from Guggenheim. Corie, Matt, I wanted to focus on trends within consumer electronics. If I look at the disclosures here in the press release, obviously, some apparent challenges in that category. So was hoping that you can expand on what you're seeing across the major subcategories within? And then maybe highlight how that is impacting the cadence of comp, right, that you're expecting for 2023?

I would imagine part of that is improvement within those subcategories. But any color there would be helpful.

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

Sure. I think generally speaking, when you look at 2023, with a minus 3% to minus 6% range, most categories are going to still feel pressure as you look at the year. Most generally would also see a progressive improvement as the year -- at the high end of our range as well. Categories are -- would be very different spots if you think about the last few years. If I think about computing, computing is still a much bigger category compared to where it was prepandemic. It's still seeing more pressure -- compared to the total, just because of the demand it's seen over the last number of years.

Appliances, again, also a very big category, growing quite a bit over the last number of years as well, seeing a bit of pressure as we start to rightsize some of that spend, but also just as it relates to the housing market being a little pressure, which -- this is a category that does have some impact from that, although a great deal of -- it is still a direct purchase. There is a housing impact. So those -- TVs we would expect actually potentially for that to be a place where we could outperform the company average as we look into this coming year. We -- in Q4, we did see a little bit of ASP pressure. As you look into next year, we believe that potentially could see some opportunity as you get into future quarters. And so those are some of the bigger trends.

The last one I probably mentioned is mobile phones. It had a sales decline in Q4, which is pretty similar to the company average. And if you compare it to prepandemic, a much smaller category as people are holding on to their phones quite a bit longer than they used to. But as you look into the year against continued improvement generally across a lot of the categories. The one area we have been seeing strength is gaming. We mentioned gaming and tablets as being a growing category in Q4. We are seeing more availability of gaming consoles, which is helping to sales trends. And so potentially an area where we see some more positive as we move into this next year. But again, a lot of that is dependent upon overall all demand as it's getting longer in its launch and availability aspect.

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

That's helpful. And then maybe just a quick follow-up, maybe for you, Corie. Curious about vendor conversations today as compared to maybe past cycles or even just the depth of the COVID are -- your comments about helping them with their direct-to-consumer sales, direct-to-consumer open-box returns, et cetera. Maybe just help phrase, right, how the relationships have evolved here, and how you sort of expect them to evolve over the coming quarters and years just given the challenges that are out there?

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

Yes. This is an interesting space for us because obviously, our vendor partners they want to succeed as well. And so when we think about things like promotionality, the question we got earlier around elasticity, these are great partnership discussions that we can have with our vendors as we think about how best to stimulate the market. And I said it a couple of times, but it bears repeating, our vendors are highly incented to continue to innovate on their products and to create the new products for the future. I mean obviously, no one's going to sit on their laurels and wait for the customers to come back. People are constantly trying to innovate in a way that will drive demand. And we are really the best place to highlight particularly that new innovation. And so the vendor partnerships have continued to evolve over time with that as the backdrop.

I think we often talk about the physical experiences with our vendors, and that remains important. Our partners continue to invest in our existing stores. And I think you can see some really beautiful vendor experiences in the 35,000 square foot remodels that we're doing as well as even some of the smaller stores that we're testing, where you have just a different take on vendor experience. So there still is this real investment and interest in how a vendor shows up in a physical experience.

But on top of that, there are so many new spaces where we're developing some different and unique partnerships. We have developed some interesting partnerships around our membership offerings. We have developed really interesting partnerships with Best Buy Ads and how they think about the access to the hundreds of millions of customers that we have that we know very well, and they can target very directly. We have deep services partnerships in many cases, we're an Apple authorized repair facility, and we're building out that services infrastructure with other partners.

And then to your point, we're starting to see some real opportunity in supply chain and fulfillment. We have a program that's called Partner Plus. We currently have 6 partners on it. Samsung is one of those where you can actually order online at Samsung and have it fulfilled in our stores. And I think there are so many spaces, especially in an industry where like we said 40% of what we sell online is picked up in store. So there is this like intricate want and need on our customer base to physically have access to that product, and we can partner pretty uniquely with some of our vendors to help provide that experience for them. And we can see a lot of opportunity for that into our future.

Operator

Next caller, please go ahead.

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

It's Greg Melich with Evercore ISI. Really 2 questions. One, Corie, I think you mentioned that average selling prices are still up from where they were a few years ago. If the 3-year comp is flattish, should we assume that ASPs are maybe up 10% and transactional counts are down 10%. Would that be a fair estimate?

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

Well, we're not going to give the precise numbers, but directionally how you're thinking about it is essentially what we're seeing. And I just want to make sure I underscore 1 more time on the ASP side of things structurally versus calendar 2019 or fiscal 2020, you've really got 2 big things happening. And that is the mix and the category mix is quite different. Larger percent of our revenue now coming from appliances and large TVs. And also second, within our categories, the mix in the premium products has increased. And I think those 2 actually reflect some of the strengths of our model, our ability to really tailor those more premium experiences, our ability to deliver and install that large cube. I think it's -- sometimes it gets a little lost in some of the other inflation conversation. That's not what's happening here. What's happening here is, structurally, we're making what I think are some really positive changes within the business model.

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

Well, I guess that's the natural follow-up. So that's the premiumization with innovation. So I guess as you go through this year in the guide and that improvement in comps from where we are now, is that improvement more based on ASP declines moderating or traffic improving or transactions improving.

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

I think as we go through this coming year, there could be some -- when we start the year, there could be some ASP pressure year-over-year, but not to the extent that we compare it to FY '20, obviously. We believe that will remain elevated. And as you get into the latter part of this year, we'll

have to see, but it's probably a bit of growth coming from the industry improving, which means demand is improving, which means it's probably a combination of units improving and potentially, give or take, some ASP increase. Again, we're not guiding it, but we probably see both as you -- our expectation is at the high end is that the industry would continue to grow and demand would come back, which would actually drive more units.

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

And then my follow-up is on services, 5% of revenue. Is that basically TotalTech as a majority of that now? Or how should we think about that in terms of building that side of the business?

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

Yes. TotalTech has become majority of that number as it's -- as we launched that membership program, it's replacing more of the stand-alone services sales that we would have had in the stand-alone warranty sales that we would have had. So we've seen it shift into being a TotalTech more based number. There is still stand-alone services and stand-alone warranty sales, but it's shifted to TotalTech.

Operator

We will take 1 last question, then hand over to your host to conclude today's conference. Next caller, please go ahead.

Scot Ciccarelli - *Truist Securities, Inc., Research Division - MD*

It's Scot Ciccarelli with Truist. I know that reduction in incentive comp is a big part of the SG&A swing. But domestic SG&A was essentially flat on a year-over-year basis on a high single-digit comp decline. That's not really easy to do. So does that level of austerity, let's call it, create a situation where retention actually starts to become a challenge, especially in an environment where a lot of other retailers are actually talking about accelerating wage pressures in '23 even on top of '22's levels?

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

Yes. So what's been interesting here, and we said it in the prepared remarks, I mean our average hourly wage is up 25% versus 2019. We were one of the first to move our wages up in August of 2020 to \$15 minimum almost 3 years ago. And so we've been making continuous investments in our workforce over the last 3 years. And what we're seeing, and we watch it incredibly closely, our turnover rates are really low compared to industry averages, and they're generally very similar year-over-year. And we -- I mean we've talked about it before. We might not be exactly a prepandemic, but we're still in the like mid-30% turnover range overall. And so that is exactly what we watch to make sure we're trying to strike the right balance here.

We are continuing to invest -- and it's not just wages, it's also hundreds of millions of dollars in benefits over the last 3-year period as well. And of course, we're going to keep monitoring that on a market level basis, but we remain laser-focused on making sure that as we adjust the operating model, we are reinvesting into those employees that we have. And I think, for some of the key roles like our general managers, our turnover is in the mid-single digits, and we tapped before about some of the tenure that we see in our [peak] slot agents or within some of our consultants. So we are very carefully monitoring constantly both the balance of pay and benefits and, frankly, some of the work-life balance and flexibility that our employees are demanding, and we continue to see it reflected, I would argue, in industry-leading turnover numbers.

Scot Ciccarelli - *Truist Securities, Inc., Research Division - MD*

For you when we kind of think about -- this company has taken a lot of cost out over the last, gosh, decade plus (technical difficulty)

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

Model is always evolving, and there are always new and interesting and different ways to take cost out. I would use -- 1 of the things that we've been talking more about lately is outlets. That is a unique and differentiated customer experience. And we're pulling different customers in who are finding great values and we see a recovery rate. We've said this before, that's 2x what we would see if we were selling that sideways or selling it outside our own channel. Cost reduction is not always about expense reduction.

It is often about finding flaws in the experience and then making opportunity kind of out of those flaws. Many of our cost reduction efforts actually have ended up and, I would argue, better employee and customer experiences. If you take some of the TV damage work that we've done over time, nobody wants to bring home a damaged TV, and there's a huge amount of cost in that for us. And so I think what we are trying to do is continuously assess our model. And then given some of the advancements we're seeing, there continues to be opportunity. We see opportunity ahead in how we run our call centers as an example. And that's a space where we've been able to pull cost out and have better customer NPS and experiences.

So this isn't -- I think sometimes it's a zero-sum kind of game that people play in their heads with cost reduction. But I think what the team is doing is really creatively finding kind of flaws in our system. And because it's always evolving, there's always something that we're learning from and evolving. So I'm really proud of the work that the team has done, and I think we continue to have opportunity.

And with that, yes, you bet. I'd love to thank you all so much for joining us today. We look forward to updating you on our results and progress during our next call in May. Thank you and have a great day.

Operator

Thank you for joining today's call. You may now disconnect your lines.

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