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BBY.N - Q4 2021 Best Buy Co Inc Earnings Call

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## OVERVIEW:

Co. reported 4Q21 enterprise revenue of \$16.9b and non-GAAP diluted EPS of \$3.48. Expects FY22 total comparable sales growth to be down 2% to up 1%.

## CORPORATE PARTICIPANTS

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

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

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

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

## CONFERENCE CALL PARTICIPANTS

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

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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by. Welcome to Best Buy's Fourth Quarter Fiscal Year 2021 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded for playback and will be available by approximately 11 a.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; Matt Bilunas, our CFO; and Mike Mohan, our President and COO.

During the call today, we will be discussing both GAAP and non-GAAP financial measures. A reconciliation of these non-GAAP financial measures to the most directly comparable 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](http://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.

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

Good morning, everyone, and thank you for joining us. During the fourth quarter, our teams across the company delivered an exceptional customer experience in a safe environment. They showed amazing flexibility and execution, managing extraordinary volume in a dynamic situation, and they strive every day to create safe shopping experiences often in the face of pandemic fatigue. As a result, today, we are reporting strong Q4 financial results, which include comparable sales growth of 12.6% and non-GAAP earnings per share growth of 20%.

We continued to leverage our unique capabilities, including our supply chain expertise, flexible store operating model and ability to shift quickly to digital to meet the ongoing elevated demand for stay-at-home products and services. Online sales grew almost 90% to a record \$6.7 billion and made up 43% of our total Domestic sales. Our stores played a pivotal role in the fulfillment of these sales as almost 2/3 of our online revenue was either picked up in-store or curbside, shipped from a store or delivered by a store employee. The percent of online sales picked up by customers at our stores was 48%, representing a 90% increase in volume. Ship-to-home volume was up 38%. And even with that increase in volume, we were able to accelerate the delivery speed to our customers on a year-over-year basis by strategically using our partners, our stores and our employee delivery. For additional context, same-day shipping volume was up 376%, and our employees delivered more than 1 million units.

From a product category perspective, the biggest contributors to the strong comp sales growth in the quarter were computing, appliances, gaming, virtual reality and home theater.

As you recall, this year, we started holiday promotions in October, which is in our third quarter. We started these events early and spread them over the course of several weeks to help avoid overly crowded days in our stores in order to create a safer shopping experience. These efforts can manage the traffic flow into our stores proved effective and evened out some of the peaks and valleys through the holiday season. As planned, it also resulted in some holiday sales being pulled into Q3. After reaching 33% comp growth in October, our growth rate moderated as we lapped last year's November and December holiday sales before accelerating again in January due to the ongoing elevated stay-at-home demand boosted by government stimulus actions. That sales growth momentum we saw in January has largely continued into February.

As a result of both the successful early holiday sales and the product availability issues the industry has been seeing all year, we continued to experience product availability constraints during the fourth quarter, which we believe moderated our holiday sales, particularly in large appliances, computing and televisions. In addition, demand for the new gaming consoles far outstrip supply across the industry as was well documented. Our teams work closely and effectively with our vendors to bring in as much inventory as possible, and inventory positions improved through the quarter.

As I step back and reflect upon the whole year, it was truly a year like no other. In addition to an international pandemic, there was social unrest across the nation and numerous natural disasters. I am proud of and inspired by the way our teams have navigated the challenges and what they have accomplished. We saw remarkable customer demand and delivered outstanding execution that led to a very strong financial results. For the year, we delivered comparable sales growth of 9.7% and non-GAAP earnings per share growth of 30%. We drove record free cash flow of \$4.2 billion and ended the year with \$5.5 billion in cash and short-term investments.

Since the beginning of the pandemic, we have responded to the impacts of it with a focus on safety and helping customers get the products they need to work, learn, cook, entertain and communicate at home. We provided customers with multiple options for how, when and where they shop with us to ensure we met their definition of safe retailing, and customers noticed. The percent of customers surveyed who said we made them feel safe while they were in our stores and while we were in their homes was consistently above 97% throughout the year.

To best serve our customers during the pandemic, we had to be innovative and flexible. Early in the year, we quickly rolled out enhanced curbside pickup across our stores to provide our customers convenience when we made the difficult decision to close our stores in March. In May, we developed an in-store appointment model that provided our customers with an option to shop in our stores as we prepare to open stores back up to customer shopping. We developed solutions like virtual consultations with advisers and video chats with our store associates.

In addition, we made significant improvements to the functionality and customer experience of our app to provide access to shopping, support and fulfillment. This served not only new users of the app, but also increased levels of customer engagement with the app. In Q4, first time launches of the app were up almost 80%, and the average number of app visits per unique user were up 34%.

During the year, we also increased our investment in support of our employees. Early on in the pandemic, we continued to pay employees who weren't working for a full month after we closed our stores to customer shopping. We paid hourly appreciation pay for those who are working on the front lines and established multiple hardship funds for anyone impacted physically, emotionally or financially by COVID. We provided enhanced benefits that included 100% coverage of COVID-related health care expenses, expanded caregiver leave, additional support for backup childcare, tutoring reimbursement and access to physical and mental health virtual visits.

Including our estimates for fiscal '22, we will have invested more than \$75 million on enhancements to our structural employee benefits over a 3-year period. In addition to enhanced benefits, starting in August, we raised the starting minimum wage to \$15 per hour for all our employees, which brought our average hourly wage for hourly employees up to \$17.67. To show our appreciation for their hard work over the past year and in recognition of their ongoing efforts in the face of pandemic fatigue, we are paying employees an additional cash gratitude bonus. In the next few weeks, all hourly U.S. employees will receive \$500 at full time and \$200 at part-time or occasional seasonal.

In addition, to help keep employees and customers safe, we are encouraging all employees to get COVID vaccinations as they are available by providing them with paid time off when they receive the vaccine and providing them absence time to be used in the event they develop side effects that warrant they're needing to stay home and rest after receiving the vaccination.

In all, the COVID-related decisions we have made since the beginning of the pandemic to support our employees totaled more than \$350 million. This includes paying employees while they weren't working during store closures, appreciation pay, guaranteed pay, bonuses, vaccination support and hardship funds.

We've also deepened our commitment to community. Last year, we made a \$40 million donation to the Best Buy Foundation to accelerate the progress toward our goal to reach 100 teen tech centers across the U.S., and we committed to making systemic permanent changes that address social injustices to improve our company and our communities. We also signed The Climate Pledge, committing to be carbon neutral across our operations by 2040, a decade earlier than our previous goal of 2050. We were honored to be recognized for our efforts by Barron's earlier this month when we were named to the top of their most sustainable public companies list. The list rated the 1,000 largest public companies on 5 key stakeholder categories: shareholders, employees, customers, community and planet.

Notably, Best Buy was also called out as the company with the leading COVID response, citing our efforts to maintain employee and customer safety, health employees experiencing hardship and continue to meet the technology needs of customers. This is the fourth time we have been in the top 5 and the second time we have been in the #1 position.

As we think about our strategy moving forward, many of the themes we discussed at our 2019 investor update came to life in a very accelerated way last year. It is important to reiterate the following 3 concepts we believe to be permanent and structural implications of the pandemic that are shaping our strategic priorities. One, customer shopping behavior will be permanently changed in a way that is even more digital and puts customers entirely in control to shop how they want. Our strategy is to embrace that reality and to lead, not follow. It is too early to know exactly how much of our sales and customer shopping activity will be via digital channels over time. But as I mentioned earlier, online sales were up 43% of our domestic -- online sales were 43% of our domestic sales in fiscal '21, and we are planning for the mix to be approximately 40% in fiscal '22. That compares to 19% in fiscal '20 and only 5% just 10 years ago.

Two, our workforce will need to evolve in a way that meets the needs of customers while providing more flexible opportunities for our employees. And three, technology is playing an even more crucial role in people's lives. And, as a result, our purpose to enrich lives through technology has never been more important. We play a vital role in bringing technology to life for both our customers and our vendor partners. These concepts are extensive and interdependent, and we are, as quickly as possible, both implementing change today and assessing future implications across our entire business, including how we evolve our stores and labor models and how we spend our investment dollars.

Our research indicates our customers look to Best Buy to serve 4 shopping needs: inspiration, research, convenience and support. And customers expect to be able to seamlessly interact with physical and digital channels. We must be ready to serve all of these needs at all times in all channels. We are building all of our experiences around meeting these needs as we move from being a big box retailer with a strong omnichannel presence to an omnichannel retailer with a large store footprint for support and fulfillment.

Fundamentally, when you're looking for help and want to be inspired, the best experience will always be in our stores, talking to one of our amazing employees. The proximity to a physical store still matters to many customers. And our stores serve an important role in fulfillment and support, and also provide awareness and convenience that are critical to retaining and growing sales. But we also know that customer shopping behaviors are changing, and we need to evolve with them.

In the fourth quarter, the pandemic drove a roughly 15% reduction in traffic to our stores, including both in-store shoppers and customers picking up online orders via in-store or curbside. And while some traffic will likely shift back to our store channel in fiscal '22, like many retailers, we believe much of what we saw last year will be permanent. Our employees and the stores will always be central to our strategy. We are simply looking at how we can best deploy our team and our physical assets to meet customer expectations and needs.

As we discussed last quarter, we are taking the opportunity to test and pilot a range of models and initiatives in order to chart the best path forward. We must balance the urgency for change with the need to learn and understand how customer shopping behavior is changing. We are already gathering learnings and iterating on our initiative. An example is our ship-from-store hub pilot that we've talked about for the past few quarters. During Q4, we used 340 stores or roughly 35% of our store locations to handle about 70% of our total ship-from-store units. We believe that we can achieve similar results, consolidating volume using a smaller group of stores as hubs over time.

In addition, in a subset of these stores, we plan to reduce the sales floor square footage and install warehouse-grade packaging, station equipment and supplies. As a result, we expect to drive both efficiency and effectiveness. We also continue to pilot reduced selling square footage and alternative layouts in a number of stores in the Minneapolis market.

As you would expect, pandemic or not, we're constantly looking at our store network, responding to customer and demographic shifts just as any retailer does. We will continue our normal review process, which involves putting stores through rigorous evaluations as their leases come up for renewal.

As we look to the near term, there will be higher thresholds on renewing leases as we evaluate the role each store plays in its market, the investments required to meet our customer needs and the expected return based on a new retail landscape. For context, we have approximately 450 leases coming up for renewal in the next 3 years or an average of 150 each year. As part of the review process, we have closed approximately 20 large-format locations each of the past 2 years, and expect to close a higher number this year. We have also been reducing the length of our average lease term, which will continue to provide us flexibility.

In addition to our physical stores, our operating model needs to evolve to meet our customers' changing shopping behaviors that have been accelerated by the pandemic. The sudden and lasting shift customers have made to shopping more regularly and seamlessly across all of our channels has forced us to look at how we get our work done. Our response to the pandemic has shown our ability to be successful when broadening the scope of responsibility of our associates and has highlighted the importance of ongoing flexibility and adaptability. This, too, was a hypothesis we shared at our 2019 investor update and was massively accelerated by customer shopping behavior changes.

Since the pandemic began, our overall headcount has been going through a transformation. As a reminder, we made the difficult decision to furlough approximately 51,000 retail employees due to store closures last April. By August, we had brought back about 2/3 of them. As we approach the fourth quarter, any remaining employees that had been on furlough were asked to return to work as seasonal employees for the holidays. As employees who are on furlough decided not to come back and other employees left as a result of attrition, we have not been backfilling positions as we consider how to adjust our operations to better meet our customers' needs going forward. As a result, we entered fiscal '21 with 123,000 employees across the entire organization, and we are leaving the year with about 102,000 team members, a decline of roughly 21,000 or 17%.

Even though headcount across the enterprise has been declining primarily due to this attrition, we still have had to make difficult decisions. Earlier this month, one of those decisions was to adjust the mix of full-time and part-time employees at each of our store locations. At an aggregate level, this was due to having too many full-time and not enough part-time employees. As part of the process, part-time roles were offered to many of the displaced full-time employees who are interested and qualified. The end result was that we laid off and provided severance to approximately 5,000 in place, the majority of which were full time. At the same time, we are adding approximately 2,000 additional part-time positions. Decisions

like these are never easy or taken lightly, but they position us to be more responsive and flexible as we continue to refine our operating model going forward in response to the incredibly rapid change in how customers want to shop with us.

It is important to add that we are intent on reskilling and retraining employees wherever possible, so we can retain our people and employees can flexibly work across all our channels. Our vision of a flexible workforce is about more than having our associates gain the knowledge and skills to be effective in more areas within the traditional store setting. It expands to include the type of interactions that have become even more relevant in a digital shopping environment. Over the past year, thousands of employees who possess unique skills were leveraged across multiple areas of our business like virtual sales, chat, phone and remote support. In addition, we are investing in people and hiring in areas like supply chain, small parcel delivery, customer care and technology in support of our long-term strategy.

As the last year has demonstrated, technology is playing an even more crucial role in people's lives. We are excited about the technology trends and innovation we see over the next several years. As expected, there has been immense innovation in the consumer health category. The fitness industry has pivoted quickly, and the category is exploding as consumers want to stay fit at home and outfit home gyms. Beyond the connected equipment, customers now have the ability to integrate data for different types of activities like rowing, biking and running into any number of wearable devices to measure their overall fitness and progress more seamlessly. There is also innovation around more chronic conditions such as diabetes and heart disease with wearables that monitor insulin levels and heart rates. Hearing aids is another category going through innovation, and we are excited to help our customers with hearing needs, both online and in our stores.

The proliferation of health-related devices has become so great, we created a health and wellness digital shopping experience accessible directly from the homepage of our website. Of course, there's an innovation curve in products that help people work at home as well.

There is an influx of products around all aspects from high-tech chairs to monitors to standing desks. These are products that were not even on vendor road maps before the pandemic and now truly complete the working-at-home experience. Access to 5G is still growing as networks are rolling out across cities. As we move into next year and the year after, it will be more mainstream and accessible for all of us. We are excited about the introduction of new products over time that will leverage the speed and capabilities of 5G beyond the mobile phone.

Of course, our customers expect Best Buy to be there to help inspire and support all their technology. Our consultation program continues to be an important differentiator, and advisers are inspiring technology solutions via customer consultations happening in homes, digitally, in stores and via chat and phone. We are also leveraging our consultation program with our partners. For example, customers can schedule an appointment with one of our advisers while shopping on [samsung.com](https://www.samsung.com).

On the support side, our total tech support program continues to receive very strong customer ratings and is a unique program that we believe only we can offer. Membership growth recovered after we opened our stores more broadly. We continue to see significant opportunity over time to evolve all of our many customer memberships, which also includes our millions of My Best Buy customers. We purposefully pressed pause on this initiative at the start of the pandemic and are planning to roll out a pilot in the next few months that will leverage our learnings from the material evolution of customer shopping behavior over the past year.

I'd also like to update you on our health business more broadly. The pandemic has only served to underscore our purpose and strategy. The adoption of virtual care and telehealth by patients and physicians has been greatly accelerated by COVID-19 and is expected to continue to grow. We see significant opportunity over the long term to make the experience much better for both patients and physicians by providing an integrated seamless technology solution that is easy to use. To that end, our Best Buy health strategy focuses on 3 areas that start with our strength in retail and build to connect patients and physicians.

The first focus area is the consumer health category I spoke about a little earlier. These products are for customers who want to be healthier, sleep better or need to monitor a chronic condition like diabetes or heart disease, for example.

The second area is active aging, which includes device-based emergency response and other services for Generation A, who wish to continue to live independently in their homes. Active aging builds on the GreatCall, CST and BioSensics acquisitions.

The third focus area is virtual care, and includes digital health caring center services that connect patients and physicians to enable virtual care and remote patient monitoring. We provide personal emergency response, remote patient monitoring and care counseling services to payers serving Medicare Advantage and Medicaid populations. And we will expand these services to help people monitor their chronic disease and connect to their physician.

Our differentiated approach combines Best Buy's in-home and care counseling services with digital health. By digital health, we mean curated monitoring devices, packaged with the consumer in mind, with a platform to distribute, activate and test the devices to ensure the consumer can use them and connect to their physician.

In fiscal '22, we plan to expand the consumer health product assortment and additional devices and services to our active aging business, and add new remote patient monitoring offerings and a new technology platform in virtual care. In order to do this, we plan to invest in people, product development and the ongoing development of our health technology platform in our data, analytics and intelligence engines.

In addition to the investments in our health strategy, our investments in technology and automation will be important aspects in defining how our model continues to evolve in the future. As has been our practice for the past 8 years, we have continued our commitment to leverage cost reductions and efficiencies to help offset investments and pressures. Our current target set in 2019 is to achieve an additional \$1 billion in annualized cost reductions and efficiencies by the end of fiscal '25. We achieved approximately \$340 million toward our new goal during fiscal '21, taking our total to \$500 million toward this goal.

In summary, during fiscal '21, we managed through the challenging environment in a way that allowed us to accelerate many aspects of our strategy to deliver on our purpose and thrive in a new and forever changed environment. Our teams collectively changed the way we do business at a pace we never imagined, and I must reiterate how proud I am of their perseverance and commitment. As a result, we advanced our 5-year plan, both strategically and financially, much further than we expected.

While we are ahead of plan in several strategic areas, the disruption of the pandemic has also impacted other strategic initiatives. For example, while our health business has proven to be even more strategically relevant to our mission, the pandemic certainly disrupted the progress and the path forward will take time. We also still have meaningful opportunity to evolve our membership and services models to drive loyalty. In addition, we will need to invest in our future as we proactively evolve all the channels of our business to deliver amazing customer experiences in a world where half of the revenue might be initiated online.

All that being said, we see a path that leads to margin expansion beyond what we articulated at our last investor update. In fiscal '22, we expect our operating income rate to be lower than fiscal '21's 5.8% operating income rate as we continue to navigate and cycle impacts of the pandemic while investing in our strategy, as Matt will discuss. We are still in the midst of the pandemic. So we are not updating with a specific metric, but we see long-term non-GAAP operating income rate that is beyond the 5% fiscal '25 target we introduced in September 2019.

Now I would like to turn the call over to Matt for details on our results and insights on our outlook for fiscal '22.

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

Good morning. Our financial results for the year far surpassed what we thought was possible entering the year. We are leading fiscal '21 with an even healthier balance sheet than we -- than when we started the year and saw our non-GAAP operating income rate expand 90 basis points versus the prior year. The rate expansion was possible due to both our ability to capitalize on the elevated demand for technology and by reducing spend early in the year in certain discretionary areas beyond the unknown -- based on the unknown situation we were facing at the beginning of the pandemic. We also accelerated strategies that allowed us to begin adjusting our cost structure to what we believe will be a permanent shift in how customers want to shop. Despite the difficult decisions we made, throughout the year, we remain committed on investing in areas we felt were most crucial to delivering our future growth plans.

Let me now share more details specific to our fourth quarter. On Enterprise revenue of \$16.9 billion, we delivered non-GAAP diluted earnings per share of \$3.48, an increase of 20% versus last year. Our non-GAAP operating income rate of 6.9% increased 40 basis points. This rate expansion was



driven by approximately 90 basis points of leverage from the higher sales volume on our SG&A, which was partially offset by a 60 basis point decline in our gross profit rate. In addition, a lower effective tax rate had an \$0.08 favorable year-over-year impact on our non-GAAP diluted EPS. In our Domestic segment, revenue for the quarter increased 11% to \$15.4 billion, an all-time high for revenue in a single quarter. Comparable sales growth of 12% was partially offset by the loss of revenue from stores that were permanently closed in the past year.

From a merchandising perspective, we had broad-based strength across most of our categories, with the largest drivers of comparable growth coming from computing, appliances, gaming, virtual reality and home theater. This growth was partially offset by declines in headphones and mobile phones.

Turning now to gross profit. The Domestic non-GAAP gross profit rate declined 50 basis points to 20.7%, primarily driven by supply chain costs associated with a higher mix of online revenue. In the fourth quarter, our online sales were 43% of our overall Domestic sales in the quarter compared to 25% last year. Although it was a smaller impact than the supply chain cost, our category mix was also a pressure this quarter. These items were partially offset by a promotional environment that was more favorable compared to last year. Our International non-GAAP gross profit rate decreased 180 basis points to 20.8%, primarily due to increased supply chain costs from a higher mix of online sales and a lower sales mix from the higher-margin services category.

Moving next to SG&A. Domestic non-GAAP SG&A increased 5% compared to last year and decreased 90 basis points as a percentage of revenue. As expected, the largest drivers of the expense increase versus last year were: one, higher incentive compensation for corporate and field employees of approximately \$55 million; two, increased variable costs associated with higher sales volume, which included items such as credit card processing fees; and three, technology investments, which also include support of our health initiatives. These increased expenses were partially offset by lower store payroll expense.

Let me share some additional context on the increased expense from our technology investments. Technology has, and increasingly will be, the foundation of how we will operate and how we accelerate our strategy. This includes continued technology investments and capabilities to support our health initiatives, increasing and improving our digital interactions with customers, simplifying task in our stores and building upon our analytics to support decisions we make on a daily basis. We are also modernizing our systems and tools as well as utilizing more cloud-based solutions. For example, we are partnering with Microsoft to leverage its cloud to help power our health care offerings. In addition, we are transforming the structure of our technology teams by bringing more headcount in-house versus using contract workers.

Let me next provide more context on \$129 million in restructuring charges from this quarter, which also include a \$13 million benefit within cost of sales. About \$88 million of the charges related to changes in our Domestic segment to realign our organizational structure with our strategic priorities. The remaining \$41 million is primarily related to our previously announced plans to exit operations in Mexico. We don't anticipate any additional material charges in Mexico in future quarters, and all of our store locations in Mexico will be closed by the end of Q1.

Moving to the balance sheet. We ended the quarter with \$5.5 billion in cash and short-term investments. At the end of Q4, our inventory balance was approximately 8% higher than last year's comparable period to support the current demand for technology. Approximately half of the year-over-year increase is related to inventory still in transit. Although trends have improved from earlier in the year, we are still experiencing constraints driven by the high demand in several of our key categories.

During fiscal '21, we returned \$880 million to shareholders through \$568 million in dividends and \$312 million in share repurchases. We resumed share repurchases during the fourth quarter after suspending activity last March. This morning, we announced a 27% increase in our quarterly dividend to \$0.70 per share. We also announced our plans to spend at least \$2 billion on share repurchases in fiscal '22. In addition, our Board of Directors approved a new \$5 billion share repurchase authorization replacing the existing authorization dated February 2019, which had a \$1.7 billion in repurchases remaining at the end of fiscal '21.

As we look to our fiscal '22, we are not providing our traditional guidance, but I would like to share our planning assumptions as we enter the year. As we start fiscal '22, the demand for technology remains at elevated levels, and the sales growth momentum we saw in January has continued through the first 3 weeks of February. The uncertainty around the administration of the COVID vaccine and the subsequent impact to customer



demand and shopping patterns makes it difficult to predict how sustainable these trends will be. Other factors to consider include government stimulus actions and the risk of continued high unemployment.

With that being said, we estimate fiscal '22 total comparable sales growth in the range of down 2% to up 1%. This range reflects a scenario in which customers resume or accelerate spend in areas that were slowed during the pandemic, such as travel and dining out in the back half of this year. Overall, we expect growth to be positive in the first half of the year and then negative in the back half as we lap strong comp growth in Q3 and Q4 of fiscal '21. We will update our expectations during the year, if needed, as there is more clarity to the various factors driving our outlook. Regardless, we anticipate revenue for fiscal '22 will be higher than what we would have expected to be at this time last year.

From a gross profit rate perspective, we are planning for a non-GAAP rate that is slightly below our fiscal '21 rate. We anticipate more promotional pressure than we experienced this past year as inventory becomes more available and competition likely increases. As Corie mentioned, we are planning for online sales to represent approximately 40% of our Domestic sales in fiscal '22, which is only slightly lower than our mix in fiscal '21. As a result, supply chain-related costs are not expected to have a material impact on our rate compared to the prior year.

From an SG&A standpoint, we're expecting dollars to increase as a percentage in the low single-digit range. There are a number of factors driving the expected increase. First, we expect our SG&A increase -- expense to increase approximately \$100 million on a year-over-year basis as we lap COVID-related decisions we made last year to preserve liquidity. This includes returning to more normalized spend on items such as 401(k) company match, advertising spend, store overhead items such as maintenance. This \$100 million increase includes the benefit of lapping the \$40 million donation to the Best Buy Foundation we made in Q3 of fiscal '21.

Second, we plan to increase our investments in depreciation -- and depreciation in support of technology and our health initiatives by approximately \$150 million compared to fiscal '21. Third, we expect store payroll costs to be lower compared to fiscal '21, even after including the impact of lapping \$81 million of employee retention credits from the CARES Act we received in the first half of fiscal '21. There are clearly other puts and takes that we will manage through, some that will be more impactful in 1 quarter versus the next, but the previous items are the key drivers of how we are viewing the full year.

Based on the drivers I just outlined, our expectation is for our operating income rate to decline on a year-over-year basis, which is primarily a result of our increased investments in technology and in support of our health initiatives as well as the impact of lapping the temporary actions from fiscal '21 I just shared. In relation to capital expenditures, we expect to spend approximately \$750 million to \$850 million during fiscal '22 compared to \$713 million in fiscal '21.

Now I will provide some color on Q1. We expect comparable sales to be approximately 20%. As a reminder, in Q1 of last year, we closed all of our stores to customer shopping and moved to curbside service only for the last 7 weeks of the quarter. We anticipate our gross profit rate will be slightly lower than last year due to more promotional environment and increased delivery expense. As a reminder, we suspended in-home services for about 5 weeks during last year's Q1.

We expect SG&A dollars to increase by approximately 10%. This increase is primarily related to incentive compensation as we suspended all expense during Q1 of last year for corporate and field employees as well as the gratitude- and vaccination-related bonuses that Corie discussed. These items combined are expected to result in more than \$100 million in additional expense versus last year. In addition, we anticipate increased expense from our investments in technology and health as well as higher variable expense associated with expected growth.

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We can now take our first question from Anthony Chukumba of Loop Capital Markets.

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

Congratulations on a strong finish to an incredible year, particularly given the COVID-19 dystopia that we're all living through.

So my question was on the competitive landscape. I mean it sounds like -- or I would guess that you're expecting things to be more competitive in 2021, as you said, as the world sort of returns to normal compared to maybe what you saw in 2020. But just would love to have your perspective on that. So that's my one question.

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

Yes, I'll start, and Matt can add color. I think we would expect, and we actually said it as Matt provided the outlook, there to be a higher level of promotionality as we start to lap some of the strengths obviously from last year, and you start to get into more normalized inventory positions throughout the year. And so part of the color, I think that Matt provided for next year would imply that. And we likely are going to have to invest a bit more to remain price competitive, which, of course, since the beginning has been our priority. So Anthony, I think your intuition is right there that we would expect things to normalize a bit in terms of promotionality.

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**Operator**

And we can now take our next question from Chris Horvers of JPMorgan.

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

Starting with a longer-term question and then I have a follow-up on something more near term. As you think about migrating to the new model, obviously, in the consumer electronics business, warranties and accessory attachment are really important. So can you talk about the -- how you see those attachment rates in-store versus a BOPUS and versus online? And are you building in expectations that you can improve that attachment rate as the consumer becomes more digital?

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

So I'm going to take a little bit of a step back here in that. I think we strongly believe our competitive advantage is our ability to provide both support and advice across all the channel -- any channel that anyone wants to shop in. And obviously, there are different challenges and different modes of doing that across the different channels. But regardless, we know our employee -- or our customers, excuse me, are looking for both that advice and that support across channels. And we've been investing in our capabilities and technology in order to deliver that.

We've also talked about the fact that what our customers expect from us from a support perspective has changed over time. And it's less about that break-fix support, although that's still important, and we need to be there when that happens. And it's much more about supporting your technology seamlessly across your devices. And it's more about -- is my printer staying on my network or is my content streaming the way that I want it to. And hence, the reason we've been migrating to a model that looks more like total tech support, which provides you obviously coverage for all the technology devices in your home, regardless of where you bought them.

And so it's not just about now -- for your question specifically, digitally, it's not just about the buying experience. It's actually about using digital across all aspects of the shopping experience. And so we have been working, and we are continuing to work, and as you think about the investments that Matt mentioned in technology, we're investing in things like video chats, virtual consultations, adding digital checkout in the app. This is still all empowered by our amazing Blue Shirts who are actually creating these experiences. We're just creating them digitally.

And so while the gross margin rate has been lower online, over time, it's constantly improving because we're constantly improving that customer experience. And we are seeing increases in our ability to transact total tech support or digital consultations, we're seeing more in home adviser

leads online as an example. So I think it's hard to replace that expertise and support you get by visiting our stores, but we are seeing customers getting more comfortable with experiencing some of those things online. And it's less about exactly which channels are happening and more about how to in every channel we interact with you, we're constantly trying to improve that experience. So to your point and your question, it does become more natural to make these buying decisions in a digital environment.

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

Understood. And then on the first quarter gross margin and inventory and promotional environment, I guess, you have a very strong comp guide in the first quarter, and it doesn't sound like you're fully in stock on items. So why would you expect a more promotional environment in the first quarter? I would -- is that something you're seeing already? It's sort of early. I would certainly expect that to be the case as you progress through the year, but it would seem like all the pieces put together, it wouldn't seem like the promotional environment would really change year-over-year.

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

Yes, I'll start and then either Mike or Corie can add. Yes, I think despite the fact that we do expect some elevated sales in Q1 as we start to enter in, especially the latter part of Q1, we're going to be seeing a competitive environment where a lot of our competitors are comping some big numbers of themselves. And so we're just aware of where that might take technology and how we need to stay competitive in that environment.

And so you're right, there's the tail of Q1 is going to be leading up to the time we closed our stores, and then we closed our stores for a bit of time in the last several weeks. So there's a lot of different areas within Q1, and we do think that towards the tail end of it, we'll start to see a bit more promotions to competitiveness as we start to see competitors react to their own situations.

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**Operator**

And we can now take our next question from Michael Lasser of UBS.

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

I mean when you laid out your comp lines for the year, how did you factor in the potential for demand being pulled forward, not just the tougher compares you're going to face in the back half? And do you think the potential for demand being pulled forward, is this for a multiyear period? Or is it unfold because of this wallet year shift back to leisure categories, it'll happen pretty quickly and be sustained just for a short period of time? And then I have one follow-up on your longer-term guidance.

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

This is Matt. I'll take that. And Corie and Mike can jump in. I think fundamentally, if we step all the way back, we believe through all technology and people's lives is only intensified as a result of the pandemic. And the proliferation of devices in people's lives will continue to support advancement as innovation continues. So in the role we play in that is extremely important and even stronger than it was before. And so as we look at next year and we think about it being probably a tale of 2 halves with growth in the first and then declines in the latter, I think we still see opportunity for innovation to keep fundamentally technology important in people's lives.

Clearly, at a micro level there, you could imagine some categories could see a little bit of pull at any given point. But there's also an element of personal savings rates being so elevated now. Right now, they're about 14%, which is twice what they were going into the pandemic. So there are a lot of puts and takes in the year. Fundamentally, the guide for next year really incorporates a view that as we get towards maybe the middle of the year, we start to see that shifting of consumer behavior back to places that were a little muted as the pandemic hit. So we wouldn't characterize the pullback, but just changing how people deciding to use their wallet.

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

I think no matter what, Michael, people's use of technology in their homes, in particular, has changed forever. You have more proliferation and you're going to have more people upgrading more products and more people trying to make different ecosystems all try to work together in their homes, which I think, regardless of the puts and takes in any one given year, is a good thing strategically for us over the longer term.

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

Okay. And my follow-up is on the comments around your expectation for your operating margin being above 5% or the level that you had laid out at your analyst meeting a couple of years ago. And obviously, at that time, it was impossible to predict the e-commerce penetration in your business would be as high as it is today this quickly.

But presumably now that would drag relative to what you expected for your profitability back then, is the offset or the entirety, the offset and even more this new model where you're going to operate a little more efficiently at the store level? Or is there other factors that are driving this expectation that your profitability is going to be higher than what you expected a couple of years ago?

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

So I'm going to start with a bit of a strategic lens on that. And then I think Matt can chime in a little bit on the profitability of the channel's kind of question. When we set that target in 2019, the good news is our strategic hypothesis was spot on. The interesting part is we have made a massive amount of progress even faster. The customer has made a massive amount of progress. We knew digital penetration was going to grow pretty substantially. What we didn't know is that it was going to double in the span of a year.

And so we need to take, and we are taking, the appropriate time to think about the longer-term given these seismic changes that we've seen. And there are lots of uncertainties, including the fact we're still in the middle of a pandemic. And so we're testing and piloting a number of different models that are going to balance this kind of urgency for change with the need to learn how the customer is changing their behavior.

But what we can see in front of us and then what we can see based on the plans we have in place is that we do think there is that room for operating rate expansion. And Matt will talk a little bit about what we're seeing even in the profitability of the channel.

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

Yes. If you think about the channels, which are increasingly hard to kind of pull apart, as you see elevated levels of online sales, you see a lot more SG&A leverage because there's a lower fixed cost basis to that. And so while the gross margins tend to be lower because they don't -- our stores provide expert service and support that only our people can give, we do see SG&A cost structure that is less. And so our job is to actually how to optimize both those channels together to provide the same level of expertise and support, but also allow the support and convenience as they work together. But that fixed cost leverage that you get online is important as you start to look further in the year with elevated levels of online mix.

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**Operator**

And we can now take our next question from Peter Keith of Piper Sandler.

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**Robert Adam Friedner** - Piper Sandler & Co., Research Division - Research Analyst

It's actually Bobby Friedner on for Peter. I just want to ask about your full year gross margin guidance and expectations to be down a little bit. I was wondering if you could discuss some of the puts and takes there. Was trying to see it down a little bit after 60 basis points of decline this year and expectations for online mix to moderate that. So just wanted to -- any detail there.

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

Sure. So if we think about gross profit next year, what we said was it would be slightly down. I think the biggest parts of that are a belief that, like we said, that there'll be a bit more promotionality and competitive environment as we start to get into the latter half of Q1 going forward. There's also periods of time where we had some -- our stores closed and we did -- we weren't able to offer all of our services for installations and delivery. There's a little bit of pressure there.

In addition, I think online mix being assumed at 40% versus 43% this last year, is not a meaningful difference in terms of the impact of supply chain costs. So that's why we don't think supply chain costs fundamentally are much of a benefit as you start to move into next year, as you are assuming the same amount of sales between the fundamental 2 years. I also think within there, you've got a little bit of promotional favorability, offset by a little bit of category mix changes that will happen throughout the year. So fundamentally, it's that assumption that online mix will stay pretty much the same.

**Robert Adam Friedner** - Piper Sandler & Co., Research Division - Research Analyst

I appreciate that. Maybe just separately, quickly. Starting on semiconductor shortages that have been going forward recently. Can you discuss how this might be impacting product availability currently or perhaps in the coming quarters?

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

Yes. No, it's Mike Mohan here. Thanks for the question. I think it was around semiconductor availability in shortage, which there's clearly a lot of that in the news right now because we need semiconductors in almost everything that's being made. We feel pretty good because we have long-term plans with our vendors upstream for finished goods, whether they're coming from Asia or parts of the rest of the world. And there's sporadic shortages just based on demand peaks right now. Our line of sight to incoming inventory feels good on where we're at. I think there'll be some impacts in other industries, but I wouldn't be the expert to speak about it here.

**Operator**

And we can now take our next question from Joe Feldman of Telsey Advisory Group.

**Joseph Isaac Feldman** - Telsey Advisory Group LLC - Senior MD, Assistant Director of Research & Senior Research Analyst

Wanted to ask on inventory, how we should think about inventory through this year. It sounded like you're still a little chasing in some categories where there's some lightness. But I was thinking as you do get back into stock and inventory was up 8.5% or so this past quarter, which seemed like in a better position, maybe you could just take us through the year how to think about it, like should we end the year or come through the year up a little bit of inventory, down a little bit? How do we think about it?

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

Joe, it's Mike. I'll start and Matt or Corie can chime in. We feel better about our inventory position now versus the last 4 calls we've had. So I'll start with that because we've finally gotten back into better stock. That said, we still have constraints in parts of our business that we don't think will

solve themselves in the first half of this year. Gaming is a good example. We have yet to put the new generation of gaming consoles into our stores. We anticipate to do that soon, but we haven't done that because there just hasn't been enough inventory to meet demand. So those are some of the things that, pandemic aside, it would have likely been constrained and is only more heightened based on people wanting to dramatically change their at-home experiences.

Other categories like printing have been constrained since the start of pandemic and there's some challenges in that industry at large getting back into a better inventory position. I think in most some of the bigger categories around computing and home theater were going through some natural time transitions. This would be now our second home theater transition, as an example, during a pandemic. And I think our vendors are getting smarter about the timing of new model introductions and then what do they use for demand generation.

So I can't give you a good window as to what our inventory will look like 12 months from now. I feel we're going to be in better stock overall, but we'll still have a handful of constraints that we have to navigate through. I think the one thing our teams really do well, and I know that you know this, but we work so far upstream with all of our partners with collaborative forecasting, demand generation, even feature sets on models, which can actually help us give us -- help give our vendors the best forecast possible. So I always look at our forecast accuracy and our percent to fill, and I feel really good about what I can see going forward. And then the rest is based on consumer demand. And I think Matt talked about there are some things on the back half of this year that we have to plan for 2 different vectors on, and I know our teams will be ready.

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**Joseph Isaac Feldman** - Telsey Advisory Group LLC - Senior MD, Assistant Director of Research & Senior Research Analyst

Got it. And then if I get a follow-up on a separate topic. With regard to digital and the stores and fulfillment, like I guess when you were talking about retraining, reskilling, is that related to having to teach the employees to do a better job of fulfilling orders and shipping and doing things beyond servicing the electronics support when people come in, like is it more about the digital support than the in-person support?

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

Thanks for that question, Joe. It's a little bit about everything you just mentioned, in fact. And so, in other words, there are multiple ways in which employees can, in many cases, opt in to gaining further certifications and skills. Sometimes that looks like within the 4 walls of the store, I might opt in to garnering more skills in home theater and computing. I might opt in to garnering more skills around services, therefore, I am more flexible throughout the store. In some cases, that might also mean I am willing to spend some of my time doing fulfillment work. Fulfilling on car side -- curbside, excuse me, orders or packing inventory in the back out of some of those ship-from-store locations. So I may add those skills, which might add more hours and more flexibility.

And then there are some new digital experiences that we are leveraging our associates for. I might opt in to being able to answer calls from a national call queue. While I'm on my shift, it's not that busy, and I can pick up a customer's question via call or I might opt in to being more of an expert that's virtual, that can help you with whatever your question is in a virtual connection through our app. All of those are different ways in which we're reskilling. And then you can imagine, on top of that, there might flexibility to go work in a supply chain location or there might be flexibility to train myself into more of a technology job and be able to do that remotely.

And so in all of those different vectors, we are actually starting to create training modules and create opportunities for our employees, not just for us to use them flexibly, but for them to flexibly opt in to different roles and different hours in a way that might meet their lives with a little bit more flexibility and progress their careers, frankly.

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**Operator**

And we can now take our next question from Karen Short from Barclays.

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**Karen Fiona Short** - Barclays Bank PLC, Research Division - Research Analyst

I actually just wanted to talk a little bit about fiscal '22 in terms of operating margins with respect to that 5% target. So when I look at the ranges that you provided, I kind of back into a range of EBIT margin of 4.2% to 4.7%. And so, I guess, in the context of that 5% target remaining intact, that does seem like a fairly, at least, on the low end, big leap to make to get back to the 5% target. So wondering if you could comment a little bit on that, and correct me if I'm wrong in terms of the math on that range. And then I have a follow-up.

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

Sure. I think, for the full year, if we think about the top -- if we use the top end of the range, 0 comp, we're likely -- our math would indicate a range that's a little bit higher than that, above 5%. That's assuming a 3-percent-ish sales -- our SG&A increase and a slight moderation or decline in operating or gross profit rate. So the top end of the range should imply something that's a little north of 5%.

Now certainly, as you start to slip towards the bottom of that range, we'll look at decisions that we need to make -- to see if -- where we want to end the year from an operating rate perspective. We do believe we're in a very strong position financially, and we probably would resist making short-term decisions to overly manufacture a rate when we know we need to invest for our future. But the top end of our guidance should imply something north of 5%.

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**Karen Fiona Short** - Barclays Bank PLC, Research Division - Research Analyst

Okay. And then wondering, just generally speaking, I know you gave a lot of details on the number of employees. Could you maybe just talk a little bit about what you think the optimal full-time versus part-time mix was? And as you said, obviously, you skewed -- or you had, I think, a higher percent of full time, but not by a much. So wondering how you're thinking about that optimal mix with the 102,000 in mind.

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

Yes. It's a little hard for me to say what's optimal when we're still striking the balance between learning about what we think our operating model is for the future and where we are today. And so I don't -- I would hesitate to comment on what we think the optimal mix is. I think what's important for us right now is we are trying to build in flexibility that will allow us to meet the customer wherever they're deciding to interact with us across both channels. And we're worrying a little less about exactly what the optimal mix is and instead really trying to figure out how best can we use that employee hour space across all the things that we need to do and therefore, staff appropriately against that.

So optimal, I don't think we know yet, given that we're still in the midst of a pandemic, we still have a lot of unknowns in front of us, but we do feel pretty strongly that we are now set up in a better position be able to flex with the changing customer dynamic.

And with that, I think that was our last question. I want to thank everyone for joining us today, and we look forward to updating you as we continue to progress against our strategies. Have a great day.

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**Operator**

Ladies and gentlemen, this concludes today's call. Thank you for your participation. You may now disconnect.

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