

# Lowe's Companies (LOW) Q2 2024 Earnings Call Transcript

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**Lowe's Companies** (LOW -1.18%)

Q2 2024 Earnings Call

Aug 20, 2024, 9:00 a.m. ET

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## Prepared Remarks:

### Operator

Good morning, everyone, and welcome to Lowe's Companies second quarter 2024 earnings conference call. My name is Rob, and I'll be your operator for today's call. As a reminder, this conference is being recorded. I'll now turn the call over to Kate Pearlman, vice president of investor relations and treasurer.

### **Kate Pearlman** -- *Vice President of Investor Relations, Treasurer*

Thank you, and good morning. Here with me today are Marvin Ellison, chairman and chief executive officer; Bill Boltz, our executive vice president, merchandising; Joe McFarland, our executive vice president, stores; and Brandon Sink, our executive vice president and chief financial officer. I would like to remind you that our notice regarding forward-looking statements is included in our press release this morning, which can be found on Lowe's Investor Relations website. During this call, we will be making comments that are forward-looking, including our expectations for fiscal 2024.

Actual results may differ materially from those expressed or implied as a result of various risks, uncertainties, and important factors, including those discussed in the risk factors, MD&A, and other sections of our annual report on Form 10-K and our other SEC filings. Additionally, we'll be discussing certain non-GAAP financial measures. A reconciliation of these items to U.S. GAAP can be found in the Quarterly Earnings section of our investor relations website.

Now I'll turn the call over to Marvin.

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

Thank you, Kate, and good morning, everyone, and thank you for joining us. Second quarter sales were \$23.6 billion with comparable sales down 5.1% from the same period last year. While we're pleased that we delivered positive comps in Pro and online sales, we continue to manage through softness in DIY demand. Although this remains a challenging industry backdrop for the homeowner, I'm pleased with our team's ability to effectively manage the business.

This is reflected in our disciplined expense management across the company, along with continued progress on our perpetual productivity improvement, or PPI initiatives. These efforts helped us respond to the pullback in DIY discretionary projects and unpredictable weather across the country to deliver better-than-expected flow-through while improving the customer experience. Later in the call, Joe will provide more detail on our improved customer service results in Q2. We're also encouraged to see results from our ongoing investments in our Total Home Strategy this quarter, allowing us to deliver mid-single-digit positive comps in Pro and 2.9% comparable sales growth online.

This demonstrates the importance of these strategic investments and shows that our Total Home Strategy is gaining traction, even in this pressured macro environment. Our resilient small to medium Pro customers are responding to the way we've transformed our product and service offerings to meet their needs. Bill and Joe will provide more detail on our successful Pro initiatives later in the call. When it comes to online sales, we delivered growth across all three business areas, driven by continued improvement in conversion rates as customers responded to our compelling offers and to our new expanded same-day delivery options that are now available on multiple platforms.

In Q2, we added Uber Eats to our list of delivery partners, which also includes DoorDash, Shipt, and Instacart, in addition to our lifestyle technology partner,

OneRail, provides a fully integrated solution available on Lowes.com and in store. As we continue to involve our omnichannel strategy, we've learned that having multiple delivery platforms extend our reach into both urban and suburban areas and helps us drive incremental sales with different types of customers, especially younger generations who are more digitally savvy. We're also reaching a broader customer base and making a deeper connection with our new and existing customers through our marketing campaigns, featuring sports icons like Lionel Messi, widely recognized as the best soccer player in the world. We have very effectively leveraged our partnership with Messi to gain exposure to our new DIY loyalty program, MyLowe's Rewards.

Overall, we're very pleased with our MyLowe's Rewards loyalty program we just launched nationwide in March. And through this program, we've learned more about our customers' lifestyle and purchasing trends, which will allow us to curate meaningful offers for them now and in the future. Now let me tell you about how we're leading the way with innovation and home improvement. Lowe's is working with Apple to help customers visualize and design their dream kitchens using Apple Vision Pro.

This past quarter, we piloted an in-store design experience for our customers in three test markets, where with the help from a Lowe's associate, customers could wear the Apple Vision Pro and use the Lowe's Style Studio app to explore and customize hundreds of kitchen designs in 3D using products, , and appliances, all available at Lowe's. This is just one example of how we are `leaning into innovation while we're also working with leading platforms like NVIDIA, OpenAI, and Palantir to develop AI solutions for both our customer and our associates to help us improve how we sell, shop, and how we work. Before I close, let me give you an update on the trends we're seeing in the macro environment. At the beginning of the year, our full-year outlook reflected our expectation that macro and consumer trends in 2024 would be similar to the back half of 2023.

That assessment has turned out to be accurate, and yet, there still remains a great deal of uncertainty, particularly around interest rates and inflation. In terms of housing specifically, we're seeing significant implications as a result of a lock-in effect. Simply put, people aren't moving nearly as often as they typically do because current mortgage rates are so much higher than their existing rates. And as a consequence, housing turnover is hovering near its lowest levels since the mid-1990s.

And the preference of spending on services, especially for the more affluent consumer, has persisted much longer than expected. That said, the three core drivers of our business remain strong. Home prices continue to appreciate, which is sustaining historically high levels of home equity. Disposal personal income is now growing faster than inflation, and the aging housing stock means people will need to make repairs and improvements in their homes.

When you combine those factors with trends like a large number of millennial forming households, baby boomers aging in place, and people continuing to work from home, we remain optimistic about the medium- to long-term outlook of the home improvement industry. And in the meantime, our operating philosophy in this challenging home improvement macro environment is very straightforward. We will continue to invest in technology and innovation. We'll offer our customers value and differentiation whenever and however they choose to shop, and we will be incredibly disciplined with our expense management.

We will achieve this by improving our operational efficiency through our PPI initiatives and making the right investments in our Total Home Strategy. Although we are unable to call the date for the recovery in home improvement, we are confident that we'll be in a strong position to take share when the market begins to inflect. In closing, I want to thank our frontline associates for their dedication to our customers and communities. One of the best parts of my job is visiting stores every week.

And in the first half of this year, I personally visited all 15 geographic regions. These store visits give me an opportunity to personally thank our wonderful associates for their hard work and provide me with valuable insights into how we can continually enhance our customer experience. Thank you again for joining us this morning. And with that, I will now turn the call over to Bill.

**Bill Boltz** -- *Executive Vice President, Merchandising*

Thanks, Marvin, and good morning, everyone. Despite continuing softness in DIY discretionary demand, we're pleased that we delivered positive online comps and mid-single-digit positive Pro comps this quarter. We now have the right brands for Pros, the right inventory quantities, and the right product assortments to meet the needs of this demanding customer. Our strong Pro performance in this challenging macro environment means that our efforts to transform the Pro customer experience are working.

Now turning to our results in building products, where we delivered above-average comps in rough plumbing, electrical, and millwork and positive comps in building materials, driven by continued growth in Pro across all building materials subdivisions. Within rough plumbing, we also drove strong results in some hot weather categories like air circulation and HVAC, and we continue to deliver strong results in water heaters. Just one warm weather example. We recently rolled out Mr.

Cool mini split air conditioners in 1,200 stores. These ductless systems are known for their advanced technology, energy efficiency, and ease of insulation, which means our DIY customers can now install their own mini HVAC system without having to hire a professional installer. Now let's shift gears to home decor. We continue to see persistent pressure in bigger-ticket DIY discretionary projects in flooring and kitchen and bath, consistent with the trends that began in the third quarter of 2023, and we continue to lead the industry in appliances.

And we are pleased with our overall performance where we delivered above-average comps and double-digit growth in Pro sales. When you put it all together, we have the whole package for custom shopping for new appliances. We have the widest assortment of the leading brands. We have a simple and seamless shopping experience, both in store and online, and we have a best-in-class fulfillment solution with next-day and two-day delivery options, thanks to our multiyear investment in our market delivery infrastructure.

And we continue to bring the most innovative products to market like the Lowe's exclusive Hisense convertible four-door refrigerator, which has a fingerprint-resistant finish and an extra storage drawer with different temperature settings that can be controlled over Wi-Fi from your mobile phone. In paint, we are now partnering with Sherwin-Williams to offer customers free same-day delivery nationwide. Since painting is the No. 1 home improvement project, we're making it easy and convenient for customers to order paint and paint supplies online and get it all delivered quickly right to their door.

This delivery option is just another added convenience, especially if you happen to run short or out of supplies in the middle of a painting project. Now let's talk about hardlines, where unfavorable weather pressured traditional spring seasonal categories like lawn and garden and seasonal and outdoor living. Given our DIY customer mix, sales pressure in these two DIY dominant categories greatly

impacted overall comp sales for the quarter. In outdoor power equipment, the addition of Toro now gives us the strongest lineup in the industry, along with John Deere, Aaron's, Eagle, CRAFTSMAN, Husqvarna, Cobalt, and SKIL.

No one can beat it. In tools, we're expanding our collection of private-branded Cobalt tools with a 24-volt paint sprayer, multi-material cutter, and finish nailer. And with our introduction of client tools and their new connect system, which is an impact-rated system of sockets, drivers, and ratchets that are compatible with both hand tools and power tools, this system is proprietary to Klein, the No. 1 brand for electricians and HVAC professionals.

And connect is also exclusive to Lowe's in the home center channel, where we now have the largest assortment of Klein tools in home improvement retail. During the quarter, we were also pleased with the success of our CRAFTSMAN Days events, where we highlighted CRAFTSMAN products for multiple merchandising divisions with more than 100 products featured both in store and online. As we look ahead to Q3 and the fall season, we have a strong product lineup ready for the fall, starting with Halloween. It's bigger than ever before with everything from new animatronics to inflatables, along with fall cleaning and fall harvest and with the decor that can last the entire fall season.

It is already available online and in store. Shifting gears, we continue to deliver on our perpetual productivity improvement or our PPI initiatives. Our marketing team is rebranding our retail media network program to a simpler platform where we help our brand partners meet a wide range of marketing objectives from performance on shelf and new product launches to seasonal promotions and multiproduct sales. We're also pleased with the progress we've made working with our suppliers to take out costs that we absorbed over the last few years.

We continue to work together with our suppliers to claw back these costs while also looking to reinvest into our marketing and merchandising strategies to drive traffic and sales. As I wrap up, I want to once again thank our supplier partners and our merchants for their partnership and hard work in bringing customers the best brands, innovative products, and compelling offers that offer value and new solutions for our customers' home improvement needs. Thank you, and now I'll turn the call over to Joe.

**Joseph McFarland** -- *Executive Vice President, Stores*

Thanks, Bill, and good morning, everyone. I'd like to start by recognizing our frontline associates. Their dedication to serving our customers is reflected in continued improvement in our customer satisfaction scores over last year. And while we continue to elevate the customer experience, we also manage staffing well in a dynamic environment and achieve greater payroll productivity.

We achieved this improvement in customer service and productivity by continuing to shift associate time from noncustomer-facing areas to focus on selling and assisting customers, which leads me to a question we often hear from our investors, namely do our perpetual productivity improvement or PPI initiatives negatively impact our customer experience. Let me address that head-on. We found that the opposite is true. For a number of years now, we've been working smarter with tech-enabled solutions that make our associates more productive while enhancing customer service at the same time.

The new in-store mode on our mobile app is a great example. When customers enter our store, they can enable in-store mode using the Lowes.com app on their phone, providing them with a detailed product and location information to help them navigate the store with ease. In addition to being a tremendous customer resource, in-store mode also helps free up associates, so they can spend more time selling and focusing on customers who need help. And we're already working on the next innovations to the in-store mode to further streamline the shopping experience.

Our PPI initiatives are also enabling us to reduce returns, which are now at historic lows for our company. There are a number of factors driving these results. Beginning with the returns desk, associates are using our modern omnichannel system, which makes the process as easy as a quick scan with the system immediately accounting for return policies. Second, we're collecting more precise information on why an item was returned, so we can work together with our vendors to address any issues and prevent returns from happening in the first place.

Third, we've identified key inflection points in our supply chain to reduce damages on more fragile items like appliances to better ensure that they arrive in pristine condition, therefore reducing returns. Even though we've already made substantial progress on our productivity journey, our team is already piloting some of the next round of innovations on our PPI road map. I'm looking forward to sharing more

details about these initiatives at our analyst and investor conference in December. Shifting gears now to Pro, where we continue to gain momentum with our core small to midsized Pro customer as we delivered mid-single-digit positive Pro comps this quarter.

The recent investments we've made in job site delivery and high-velocity Pro SKUs are paying dividends, making it easier for us to fulfill larger orders and quickly replenish inventory within our store. And we're delivering outsized growth in Pro online sales as Pros appreciate the enhanced online shopping experience that we've created specifically for them. Looking ahead, we were pleased to hear from Pros on our recent survey that their backlogs remain healthy and consistent with last year. And what's also encouraging is that 75% of Pros are confident in landing new business.

Our EVP of Pro and home services, Quonta Vance, will discuss the next phase of our Pro growth strategy at the December analyst and investor conference. Before I wrap up, I want to thank our associates who contributed to our disaster relief efforts to help customers recover from storms, including Hurricanes Beryl and Debby. Lowe's command center, merchandising teams, and supply chain teams went into action to pre-stage merchandise at key locations to be able to quickly respond to customers' needs, both before and after the storms. I'd like to extend my appreciation to all of our associates for their tireless efforts to serve our communities in their time of need.

And now let me turn it over to Brandon.

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Thank you, Joe, and good morning, everyone. Beginning with our Q2 results, we generated GAAP diluted earnings per share of \$4.17. In the quarter, we recognized a pre-tax gain of \$43 million on deferred consideration associated with the 2022 sale of our Canadian retail business. Excluding this benefit, we delivered adjusted diluted earnings per share of \$4.10.

My comments from this point forward will include certain non-GAAP comparisons that exclude this benefit where applicable. Second quarter sales were \$23.6 billion with comparable sales down 5.1%. Comp sales were pressured by continued softness in DIY bigger-ticket projects, in line with our expectations. Also, unfavorable weather pressured sales in seasonal categories.



Comparable average ticket was up 0.8%, helped by strength in Pro heavy categories, as well as less average selling price pressure in appliances, as we begin to cycle the normalization of promotions within the category. Comparable transactions declined 5.9% with pressure from DIY project spend, as well as lower seasonal transactions, partly offset by growth in Pro transactions. Our monthly comps were down 6.4% in May, 4.1% in June, and 4.9% in July. Colder and wetter weather in May was quickly followed by intense heat across much of the country in June and July with both weather patterns pressuring outdoor spring activity.

Gross margin was 33.5% in the second quarter, down 19 basis points from last year due to continuing supply chain investments, partly offset by lower transportation costs and ongoing PPI initiatives. Adjusted SG&A of 17.3% of sales delevered 87 basis points due to sales deleverage, as well as the cycling of a favorable legal settlement. These impacts were partially offset by continued enterprisewide PPI efforts and our quick pivot to manage expenses in line with sales that were adversely impacted by inconsistent weather trends. Adjusted operating margin rate of 14.4% declined 114 basis points, and the adjusted effective tax rate of 24.2% was in line with prior year.

Inventory ended the quarter at \$16.8 billion, down \$581 million compared to Q2 of last year, as we continue to align inventory levels with demand while also investing in high-velocity Pro items. Turning now to capital allocation. During the quarter, we generated \$2.7 billion in free cash flow. We repurchased 4.4 million shares for \$1 billion and paid \$629 million in dividends at \$1.10 per share.

We also announced a 5% increase to \$1.15 per share for the dividend paid on August 7. Capital expenditures totaled \$426 million as we continue to invest in modernizing our technology infrastructure and our strategic growth priorities. Adjusted debt to EBITDAR finished the quarter at 3.03 times, and we delivered a return on invested capital above 30%. Now turning to our financial outlook.

Sales in the first half of the year performed largely in line with our expectations. But as Marvin mentioned, the home improvement backdrop remains challenging, and consumer sentiment remains weak. Based on these factors, we are updating our full-year 2024 outlook. We are now expecting sales in the range of \$82.7 billion to \$83.2 billion with comparable sales in a range of down 3.5% to down 4%.

We also now expect full-year adjusted operating margin in a range of 12.4% to 12.5% as we continue to tightly manage expenses while also investing in our

strategic priorities. Additionally, we expect full-year net interest expense of approximately \$1.4 billion and to repay a \$450 million bond maturity in September. We also expect capital expenditures of approximately \$2 billion and an adjusted effective income tax rate of approximately 24.5%. This results in an updated outlook for adjusted diluted earnings per share of approximately \$11.70 to \$11.90.

Now to assist you with your modeling, here are a few points to consider for the back half of the year. We are expecting third and fourth quarter comp sales to be roughly 200 basis points better than our second quarter results, given the easier prior-year compares, and we also expect operating margin rate for the second half to be roughly in line with prior year with Q3 approximately 70 basis points below prior year rate and Q4 to be approximately 50 basis points above prior-year rate. The quarterly differences are driven by the timing of merchandising PPI initiatives as we turn through our inventory, as well as comparisons to prior-year incentive compensation expense and year-end discretionary bonuses. And finally, we are reconfirming our capital allocation priorities.

We will continue to invest in the business to drive long-term growth while maintaining a 35% targeted dividend payout ratio and then use the remaining cash flows to fund share repurchases. This disciplined approach to capital allocation combined with improved operating performance almost tripled ROIC over the past five years. In closing, we are confident in our ability to execute at a high level as we navigate these near-term market uncertainties while making the right investments in our Total Home Strategy all while continuing to drive sustainable shareholder value. And with that, we will open it up for your questions.

## Questions & Answers:

### Operator

Thank you. [Operator instructions] Our first question is from Simeon Gutman with Morgan Stanley. Please proceed with your question.

### Simeon Gutman -- Analyst

Good morning, everyone. I have one question about top line and then second about margin. So the first question on the spread between DIY and Pro. I don't think we have that for every quarter, but call it, 15-point spread.

It looks like the highest number in a long time, if that's fair. And it would imply you're taking share in Pro, but it looks like you're losing some in DIY. Is that fair? And then if you look across geographies, how does the spread vary? Is it a function of the Pro spread? Is it a function of DIY? And then what's causing that spread to vary, if so? Thanks.

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

Simeon, this is Marvin. I'll take the first part of that. I think what's difficult for us to determine in home improvement is where you're actually losing or gaining share specifically in the categories of DIY and Pro. I get the foundation of your question, but one thing we can confirm for sure is that our Pro business is growing, so we do believe that we're taking share, just based on the maturation of the strategic initiatives that you heard from me, Joe, and Bill.

As we look at the DIY, the best way for me to explain and answer the question is our sales are much more concentrated in bigger-ticket DIY discretionary purchases. And when you look at big-ticket discretionary projects in the second quarter, the DIY demand was softest in those categories and in those projects. As you mentioned, we're still roughly approximately DIY. So any pullback in these big-ticket discretionary categories is really more of a disproportionate impact to us.

So I don't know that we're losing share in DIY as much as the dynamic of these big discretionary projects in the quarter affected us, and that's really the way we're looking at it. Now here's the good news. The good news is we feel great about our assortment from a merchandising perspective. We feel great about our pricing, our execution, our marketing, and we believe this is just a macro issue that we're dealing with relative to DIY big-ticket discretionary.

So when we look at Q2, even though it was a challenging economic environment, we feel great that we could grow mid-single-digit positive comp in Pro. We could deliver almost 3% growth online, and we're still managing through macro headwinds with DIY discretionary spend. So we believe that when the DIY market inflect at some point in the future, we're in a perfect position to take overall market share in home improvement because of the strength we're seeing in Pro and online. So with that, I'll let Brandon take the second part of the question.

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Yes. Simeon, your question on geographic differences, really pretty consistent. Marvin mentioned the growth in Pro. That's driven by both transactions and ticket.

But when we look across our geographic divisions, very consistent performance and taking share regionally consistently there. And then on the DIY side, again, too, really no notable geographic differences outside of the hurricane impact that we saw around the July time frame with Hurricane Beryl coming through the Houston geography. But other than that, really consistent.

**Simeon Gutman** -- *Analyst*

OK. And then my follow-up on margin, it looks like in the second half, the conversion or the relationship between the comp and the margin, it looks a little weaker than maybe the first half. It doesn't look terrible, given the comp, but it looks a little weaker. So I want to ask if that's because of anything that Lowe's is doing differently, how you're managing your business, how you're making investments, or is it simply a function of those things? Brandon, you mentioned some of the lapse of incentive comp, and I think there was one other thing.

So is it internal or external?

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Yes, Simeon. It's really the latter. The updated full-year operating margin outlook is very consistent when you look at it annually with our rule of thumb, 14 basis points of contraction on the downside for every point of comp decline. And as you mentioned, second-half quarterly differences are driven mainly by the timing of the merch PPI initiatives as we turn through the callbacks and then what we're cycling over as it relates to prior-year incentive compensation.

We called out last year \$140 million of frontline bonuses that we paid in Q4, so it's really a function of those two things. Gross margins for the year, as we've said consistently, we expect roughly flat for the full year, and that's what's embedded in the operating margin outlook.

**Simeon Gutman** -- *Analyst*

Perfect. Thanks. Good luck.

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Thank you.

**Operator**

Our next question is from the line of Steven Zaccone with Citi. Please proceed with your questions.

**Steve Zaccone** -- *Citi -- Analyst*

Hey, good morning. Thanks very much for taking my question. I wanted to follow up on just understanding the guidance cut as well because it seems like the Pro business is kind of outperforming expectations. So if you have to dig a little deeper into the DIY side of the business, maybe parse through some of the categories on home decor and hardlines, what's really the biggest change to your outlook? And given the fact that sales have been coming in a little bit weaker than expected for longer, does that temper your view on a potential recovery in DIY demand?

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

So, Steven, thank you for the question. I'll take the first part of it. Look, I think, for us, when we think about our guidance change for the year, it really comes down to just being prudent and being cautious based on the macro environment and the overall customer sentiment specifically around big-ticket DIY discretionary spend. We're all aware that we have an environment of elevated interest rates and inflation.

And because of that, the DIY customer is just on the sidelines, waiting for some form of an inflection to take place. So we can't call when that's going to happen, but we felt based on what we saw in the second quarter that it was prudent just to take a cautious approach to our guidance for the second half. And really, that's what we decided to do. I'll let Brandon take the rest of your question.

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Yes. Steven, this is Brandon. Just a little more context on the guide. As we mentioned in the prepared remarks, first half, really largely in line with our expectations when you exclude the weather impacts that we experienced.

And as we look into the second half, just as Marvin just said, we still continue to see a very cautious consumer, home improvement backdrop that remains challenged. And for those reasons, we decided to make an adjustment to the guide, and it does capture ongoing both DIY and Pro trends. And we're continuing to manage through the DIY challenges in the big-ticket discretionary, but we are still seeing strength, especially in the small to medium Pro, and that's reflected.

Just as a reminder, we're cycling a pretty big DIY pullback, which started in Q3 of last year, again, as it relates to the big-ticket discretionary.

So the breakdown as it relates to comp, we are expecting, just like we've seen here in the first half, roughly flat average ticket in the second half as the Pro growth is offsetting some appliance pricing pressure that we're seeing. And then we expect to see the transactions as the offset. That's where the pressure is at, and we continue to expect that to be challenged as the homeowner is less engaged with home improvement activity in the second half. So that's a little bit more of a breakdown as it relates to second-half guide.

**Steve Zaccone** -- *Citi -- Analyst*

That's helpful. Thanks for that extra color. I have a brief follow-up just on pricing. There's been focus on pricing and the risk of promotions impacting the industry if demand stays weak.

You actually saw ticket growth in the quarter. But do you see that as a risk at all, just pricing and promotions kind of trickling into the industry if demand stays weak?

**Bill Boltz** -- *Executive Vice President, Merchandising*

Yeah, Steven. This is Bill. So we actually see our -- the promotional activity remaining relatively stable. When you get around certain events, Memorial Day, July 4, etc., you've got offers that are out there that are seasonally relevant.

And we try to make sure that we're out there meeting the consumer at that time as well. And so when you look at Q3, we've got Labor Day in front of us, so we're going to be out there making sure that we've got seasonally relevant offers that are out there for that time as we shift gears into the fall season. But from a promotional activity, we're relatively stable. And we're seeing on the appliance side that we're back to more of a normal activity as it relates to how the appliance industry is going to market, so nothing really out of the norm.

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

And, Steven, this is Brandon. I would just reinforce that the ticket increase is not a function of pricing so much as it's just the strength that we're seeing in the Pro business, which is lifting ticket. And then as Bill mentioned, the cycling of the promo environment in appliances. Broadly speaking, as it relates to pricing environment, really largely stable here over the last couple of years.

There's always pockets of activity that we see, but the ticket has been and the pricing environment has been largely consistent since 2022. And the industry continues to be disciplined and rational. So for those reasons, we expect the ticket to continue to hold as we look across the second half of the year.

**Steve Zaccone** -- *Citi -- Analyst*

OK. Thanks for the detail. Best of luck in the second half.

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Thanks, Steven.

**Operator**

The next question is from the line of Christopher Horvers with J.P. Morgan. Please proceed with your questions.

**Christopher Horvers** -- *Analyst*

Thanks, and good morning. So first, a clarification. To confirm, you expect 3Q and 4Q comps to be basically the same or sequentially improving over the year. Related to that, how much do you think weather actually was a headwind to comp in the second quarter? And any comment on where you are trending quarter to date relative to the updated expectations?

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

So, Chris, first part of your question, the comps are relatively evenly split when you look at Q3 and Q4 as it relates to what's embedded in the guide. And then the question on weather impact, and in particular, as it impacted our DIY seasonal business, so we did see unfavorable weather in Q2. It pressured sales, cold and wet weather in May, followed by the intense heat that we saw in June and July. Just as a reminder, we are cycling over a strong seasonal performance last year Q2.

We saw that especially in live goods and smaller outdoor projects. And outside of just seasonal, the intense weather also impacted other outdoor, call it, nonseasonal projects like exterior paint and decking. And then the last thing I'll call out, we did see pressure in big-ticket discretionary seasonal categories like patio and grills, but that was largely expected as we've been managing those seasonal buys down to more recent trends that we've seen. So that was the pressure.

That was mainly where we saw the deceleration in comps from as we move from June to July. And then I would say as it relates to your question on August, very much playing out through here the first two-plus weeks, very much in line with what we've guided to Q3.

**Christopher Horvers** -- *Analyst*

Understood. And then in terms of the gross margin outlook, so it would seem like you're basically expecting gross margin to be down again perhaps more significantly in the third quarter as we -- is that fair? And then as you think about the flow of the vendor clawbacks, this would imply that really the clawbacks are starting in the fourth quarter and then will sort of continue in the first half of 2025. Thanks very much.

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Yes, Chris, so not down. We are expecting it to be up, both in Q3 and Q4 of this year. But again, on the year, roughly flat. And I'll mention just a couple of the pushes and pulls.

We continue to make the supply chain investments nearly complete with the rollout of market delivery, investments we're making in early innings on Pro fulfillment. And then as you mentioned, the merchant supply chain PPI initiatives, the clawback is going to continue to benefit, and it really starts to accelerate in Q3, Q4. And as you mentioned, turning into '25, there's a lagged effect there just with how that turns through inventory. Transportation cost continues to be a good guy for us as we leverage our scale.

And then credit and shrink, expect those to be roughly flat for the full year and a great job by the teams managing pressures in those two lines. So you're seeing that largely those things played out here in Q2 with the progression that we saw nicely from Q1 to Q2. And those same things roughly play out for the full year.

**Christopher Horvers** -- *Analyst*

Thank you. Have a great Labor Day.

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Thanks, Chris.

**Operator**



Our next question is from the line of Scot Ciccarelli with Truist Securities. Please proceed with your questions.

**Scot Ciccarelli** -- *Analyst*

Good morning, guys. I guess a high-level question on your earnings algo. This will be basically the third year of negative comps. I guess, theoretically, if comps were to stay negative in '25, is there a point where deleverage actually accelerates because of the fixed cost nature of your model?

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Yeah. I would say, Scot, we expect our kind of rule of thumb in the algorithm. We expect that that still holds, and it's directional, and it applies mainly to the fiscal year. We still see plus 10 basis points on the upside for every incremental point of comp and then 15 basis points on the downside.

That's what's reflected in our full-year guide, and we're working really hard to kind of stay consistent with that. It's not a natural output with all the work we've been doing across the portfolio with PPI. And then you referenced our overall road map. We'll talk more about 2025 in December, but really, the framework still holds, everything we've been driving from a PPI standpoint, offsetting investments we're making in gross margin.

On the SG&A side, same thing, investing or offsetting investments that we're making in wages, inflationary pressures, strategic investments. And it really comes down to the fixed cost leverage and our ability to grow top line. But when we do that, we believe we stay consistent with that framework, and we can see the expansion.

**Scot Ciccarelli** -- *Analyst*

Helpful. And then just a quick follow-up. Did additional changes to incentive comp had a significant impact on second quarter and your back-half outlook? In other words, is that something we have to kind of consider as we think about '25 earnings outlook?

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Very consistent. The only thing from an incentive compensation standpoint is what I referred to with the noise in Q4 on the 140 discretionary payout in Q4 but largely consistent there. Nothing that would need to change or be factored in.

**Scot Ciccarelli** -- *Analyst*

Great. Thanks a lot, guys.

**Operator**

Our next questions are from the line of Kate McShane with Goldman Sachs. Please proceed with your questions.

**Kate McShane** -- *Analyst*

Hi. Good morning. Thanks for taking our question. We were wondering if you could speak to how you're managing your inventory levels.

I know inventory was down on a dollar basis in the quarter. But how are you thinking about inventory in the context of maybe a slightly more cautious demand environment in the second half, as well as possibly having to manage a higher ocean freight environment?

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Yeah, Kate, really pleased with the ability of the team to manage inventory. We continue to manage it with the sales trends that we're seeing. As inventory declined faster than sales, inventory is down 3.3% year over year. We remain focused on making the investments in Pro depth and brands to support and accelerate the Pro growth that we've talked about.

We feel like we're in a great position on in-stock levels. And then from a seasonal inventory standpoint, also in a good spot as we've managed the seasonal bias to the trends we're seeing. And I think you also mentioned freight rates. From a transportation standpoint, we continue to see lower transportation costs as we've leveraged our scale to drive the lower rates that we've seen with our carriers, mostly insulated from that because we have contract pricing.

And we see those favorable rates kind of extending through the first part of 2025. So we expect the favorability that we've seen in Q2 to kind of extend through the remainder of the year, and that's baked in our gross margin guide.

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

And, Kate, this is Marvin. One thing we don't talk a lot about is how we've converted our regional distribution centers to be more of a flow-through of product versus stocking a product. If you go back to six years ago, these RDCs were basically the traditional hub-and-spoke distribution centers that basically

held and stored inventory and replenished stores, and that really put a lot of pressure on turns and overall inventory position. But over the years, the team has converted that to being majority flow.

So we're just becoming more of a cross-dock type of environment, and we have a very small percent of the inventory being stocked. That will continue to evolve over time. And as Brandon noted, we continue to make investments and finalize our build-out of our market delivery. That also puts us in a great position to continue to be the industry leader in appliances without having to hold that inventory the way we did years ago in the back of every store.

So there are cost of things that we're working on that's going to give us the ability to improve our insight position but also improve our turns at the same time.

**Kate McShane** -- *Analyst*

Thank you.

**Operator**

Our next question is from the line of Robby Ohmes with Bank of America. Please proceed with your questions.

**Robert Ohmes** -- *Analyst*

Thanks for taking my question. Really just two quick questions. Just on the back half and just going forward from here, the PPI initiatives have been amazing on the expense side. How much room is left? At what point do you get to diminishing returns on that in terms of managing expenses? And when we look at the back half, is it really more incentive comp and bonus comparisons that support SG&A being lower than it might otherwise be versus PPI initiatives?

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Robby, this is Brandon. And so you mentioned PPI. We're really proud of the progress that we've made with PPI and broader expense management. We're offsetting over \$500 million in associate wages, inflationary pressures, and strategic investments that we're making here.

In 2024, the road map covers all aspects of the company stores, merchandising, supply chain, technology, our back-office expense infrastructure. You heard Joe and Bill kind of reference a number of things going on there. And I would say we have great alignment across the organization to continue to maintain that

discipline. And as Joe mentioned, increasingly able to enhance our customer experience while also driving productivity with tech-driven solutions.

So I'll toss to Marvin. Anything else you want to add there?

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

Yeah. I'm going to just let Joe and Bill talk a little bit about PPI. To Brandon's point, I mean, we are incredibly pleased with the progress that we've made. Initially, our productivity improvement initiatives were focused almost exclusively on store operations.

And now we've created a culture where every functional area is driving their own PPI initiatives to not only drive improvements in the business and productivity but also just driving overall efficiencies. So I'm going to let Joe talk a bit about operations, and then Bill will talk about merchandising and what we're going to be seeing, not only in the back half of the year, but going forward. So Joe, we'll start with you.

**Joseph McFarland** -- *Executive Vice President, Stores*

Sure, Robby. Thanks for the question. And while we've made a lot of progress, we're only in the middle innings of the productivity journey, a lot of runway still in front of us. I've talked about things in the past, front-end transformation.

We're not even 50% through our front-end transformation. This is not only focused on the operations side but also the sales side. And so we work hand in hand, things like our activity-based labor model that we continue to invest in. We've continued to refine the advanced labor management tools that we're using today.

And also, the MST program that has added 30,000-plus associates to the sales force. And so as the teams continue to work together, we continue to see a lot of runway ahead, streamlining the back-end processes are still in front of us and a lot more to go. And so I'll toss it over to Bill for --

**Bill Boltz** -- *Executive Vice President, Merchandising*

Yeah. Thanks, Joe. Robby, on the merch side, I hit a couple of them in my prepared remarks. We're working on costs with suppliers as an ongoing process, and the merchants do that on a daily basis through product line reviews, business reviews.

But assortment productivity is part of what we do on a weekly basis and making sure that we've got the right stuff in the stores and online. I hit on retail media network. That's part of what we're doing as well, making sure that working with our vendor partners to look at different options in regards to how we put marketing strategies together, our private brand work that we've been doing over the last six years to focus on opportunities of where we can put private brands into our assortments. Those opportunities to put those products into our assortment typically come with a higher margin.

And so that offers that opportunity to put a better-performing product in the assortment. So those are just a few examples on the merch side.

**Robert Ohmes** -- *Analyst*

It sounds great. Thanks so much, guys.

**Bill Boltz** -- *Executive Vice President, Merchandising*

Thanks, Robby.

**Operator**

Our next question is from the line of David Bellinger with Mizuho Securities. Please proceed with your questions.

**David Bellinger** -- *Mizuho Securities -- Analyst*

Hey, good morning. Thanks for taking the questions. So again, good continued progress on the Pro, up mid-single digits. What's the next iteration for your Pro customer? Are there additional levers we can see take shape, maybe more brands, loyalty, working upstream with somewhat larger Pros? And does Lowe's do anything today in terms of trade credit with the Pro customer base?

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

Hey, David, thank you for the question. I think, first, if we could take a step back and think about what we've done thus far. And one of the things that we identified from the very beginning of this transformation was the fact that we needed a very consistent and coherent approach to how we serve the core customer. And really, it started with service levels in the store because regardless of what level of fulfillment and fulfillment capabilities you have in home improvement, your stores will still be an incredibly important part of the fill-in project nature need for the Pro customer.

And so our service levels were subpar at best. And so Joe and team have done an incredible job of elevating those standards, and then we had to get our product assortment right. We had customers who no longer shopped with us because there were brands that they were loyal to that literally had stopped selling to Lowe's, and so Bill and his team has done an equally incredible job of bringing those brands back to us. Bill noted in his prepared comments just the success of our relationship with Klein tools.

And Klein was one of those customers that when we arrived was no longer doing business with Lowe's. And it remains the No. 1 brand for electrical and HVAC Pros. And then we have to get committed to our inventory levels.

We talk a lot about job lot quantities, but we had to do that in a way that we gave Pros confidence and also in a way that we would not leave our stores vulnerable for large purchases that we could replenish quickly. And so after we established those foundational things, we knew that the next step was creating stickiness where you would give those customers a reason to shop us versus the competition, rolled out our loyalty program a little over a year ago, and then we rolled out a more sophisticated CRM platform. And now we're continuing to build on all of those things with more job site fulfillment. And so Quonta Vance, our EVP of Pro and home services, at our upcoming analyst and investor conference is going to lay out our long-term vision of where we plan to take Pro.

And that's going to have a lot to do with identifying segments of Pro that we are barely scratching the surface today from a share standpoint that we're going to start to pursue, in addition to ways we're going to enhance fulfillment and how we're going to be able to bring a more digitally friendly relationship with Pros, so they could have a large selection of product choices and do it in a more seamless nature. We're incredibly excited about our Pro customer. And as I said earlier, we believe strongly that the pressure that we're feeling with the discretionary big-ticket DIY is, in large part, a macro influence issue. And so as we now have momentum with the Pro, momentum with our digital strategy, we believe that when the marketplace inflects and the DIY customer starts to have a stronger confidence in making those discretionary purchases that we're going to have the full flywheel effect of our market share gains.

In the meantime, we're going to be incredibly disciplined on these key parts of our business. But we're very excited about what we're doing in Pro, but more

importantly, what we're going to be doing in the future.

**David Bellinger** -- *Mizuho Securities -- Analyst*

Thanks, Marvin. That's very helpful. And then I also want to ask on the rural store performance. I'm not sure if you called that out in the prepared remarks.

Just any change in trend there? And then secondly, there's been some mention of faster delivery times, one-day, two-day shipping to those markets from a major e-commerce player. How should we think about any potential impact for the more rural Lowe's store base, just given that development?

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

Well, the great thing about our gig network and the work that we've done online is that we're serving all customers and giving them ability to get same-day, next-day fulfillment across all of our partners. We feel really good about what's happening in our rural markets. They performed to our expectations. We are piloting a lot of unique and different initiatives in some of these stores, and you could argue that we're pressure testing some of these locations to see what works and what does not work.

One thing I will tell you is that we're still very excited about what we're doing with our workwear initiative, specifically with Carhartt. We're excited with what we're seeing with our pet food and pet initiative overall and what we're seeing with just the ATV and other activities our rural customers participate in. But we're pleased with our rural performance. We're pleased that we're able to take this digital gig platform and serve customers in both urban, suburban, and rural areas.

And we're just continuing to build on that. And we'll provide more context when we get together in December, but we think rural is going to be a significant part of our growth strategy.

**David Bellinger** -- *Mizuho Securities -- Analyst*

Got it. Thank you very much.

**Operator**

Our next question is from the line of Zach Fadem with Wells Fargo. Please proceed with your questions.

**Zachary Fadem** -- *Analyst*

Hey, good morning. If we assume the Fed starts easing in the next couple of months, what level of rate cut or rate level do you think is the right level to start stimulating demand in the category again? And is there anything in your history that would suggest a faster recovery one way or the other in Pro or DIY side?

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Zach, this is Brandon. As it relates to the interest rate environment, so for us, it's difficult to know at what absolute interest rate level we're going to see our consumers fully engage or how long the demand will lag the actual rate cuts that we're seeing. We absolutely, as we sit here today, see pent-up demand in the business. But on the flip side, when we look at consumer sentiment, that continues to remain weak.

We are hopeful that the lower rates, the drops that we're seeing are going to have a dual impact of one, relieving pressure on consumers; and then secondly, driving the existing home sales activity. But the reality is when we look at the lock-in effect, the majority of homeowners are still at 4%. Mortgage rates are less. So even if we do see some level of decrease that we do believe there still may be a reluctance to engage.

So we're staying close to it beyond the rates. Marvin reiterated the primary drivers of our business, and that's been consistent. So we're balancing rate activity with some broader recovery that we see across some of these other metrics that we track very closely.

**Zachary Fadem** -- *Analyst*

Got it. And -- thanks, Brandon. And I don't want to front-run the analyst day too much, but you have talked about a long-term margin for this business of about 14.5%. And given where we are today and the changes that have occurred since you first provided that outlook, curious if it's still the right way to think about the business long term.

And what level of top line and near-term recovery do you think we need to see to reach that level?

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Yeah. We'll hold off on getting too much into that detail. I think the punchline, Zach, is the framework still holds. It is -- as we look relative to what we talked about in December of '22, I think the degree of step back now that we've seen in



'23 and now that what we're seeing in '24 is a little bit worse than our original expectations, but we're not going to call the turn or the inflection point.

We do believe there's a lot of pent-up demand. We do have a lot of confidence in the medium- to long-term drivers. When we do get back to kind of that mid-single-digit recovery in comp that we've traditionally seen in home improvement, we believe we can outpace that with the initiatives that we have in place. And the degree and the timing of the expansion on operating margin, again, is going to be contingent on the pace in which that top line recovers.

**Zachary Fadem** -- *Analyst*

Got it. Thanks for the time.

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Rob, we have time for one more question.

**Operator**

Our final question comes from Brian Nagel with Oppenheimer. Please proceed with your questions.

**Brian Nagel** -- *Analyst*

Hi. Good morning. Thanks for taking my question. So my first question, I guess a bit of a follow-up to that -- the prior question was on rate.

So I'm going to go to a different direction. I mean, look, I think you as an operator, we as investors are waiting for a more accommodative rate environment to underpin better demand within home improvement. So the question is, as you look at your business, we've seen this malaise continuing to take hold, maybe even intensify over the past several quarters. Where are the incremental risks? Where could the business actually get weaker here before we get that rate relief, if you will?

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

Brian, this is Brandon. Look, mortgage rates obviously come down. We expect that to continue to come down further as we turn into '25. But we look at consumer sentiment, existing home sales, housing affordability, those are still concerns.

We continue to see pressure there. Consumers are still showing a preference for services versus goods, especially in home improvement. An improvement in these

macro trends, we should see and drive sustained increase in discretionary projects in DIY traffic. So particularly in the bigger-ticket categories, which is what we're watching for, that's the inflection that we expect.

But in terms of the timing and our ability to call that, that's what's unclear to us at this point.

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

So, Brian, this is Marvin. I'll take another angle at your question. And so, for us, obviously, we don't have a crystal ball to call the inflection when that will happen nor to Brandon's earlier comments, can we pinpoint what rate environment we have to be in before it starts to positively inflect this DIY discretionary pullback for big ticket. But what we're trying to do is in this headwind environment that we're in is just continuing to leverage our great balance sheet, to invest in technology and innovation, to make sure we continue to execute our Total Home Strategy, which is allowing us to pick up share in Pro, improve our online business, continue to build out a technology platform for our home installation business, which was incredibly neglected from a technology standpoint for many, many years because we know that when the inflection happens and the DIY return, we want to be perfectly positioned to really take share, not just in DIY, but also across all the other elements that I talked about.

So rather than sitting back and waiting, we're aggressively working in this downturn leveraging our balance sheet to do these aggressive investments and position ourselves so when it happens, whenever the macro inflection occurs, we just want to be ready to take advantage of it, and we think we will be. And so we're just fortunate that we have the ability to continue to be aggressive in all those areas and just preparing for the eventual time when the market will open back up again. And we're going to be prepared when it does.

**Brian Nagel** -- *Analyst*

That's very helpful. I appreciate it. And my quick follow-up, I guess this is more for you, Brandon. But just with respect to the commentary around Q3.

So the comps in Q2 down, call it, 5%. You talked about a 200-basis-point improvement. So -- and I think in response to someone else's question, you said you're basically right there now. So does that mean the business is running at a negative rate? Is that the math?

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

So, look, I will rescue Brandon from that question and answer for him. We tend not to be that precise with current monthly trends. The best way for me and us to answer that question, Brian, and I appreciate the question, is when we look at our current business trends, they are reflective of guidance we gave, understanding that our business will fluctuate throughout the quarter. And so we're not going to give a specific comp percent other than to say we feel confident that our current trends reflect the guidance we gave, and I think that's probably the best efficient way to ask it.

**Brian Nagel** -- *Analyst*

Appreciate it. Thanks, Marvin. Thank you.

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

Yeah, thanks for the question.

**Kate Pearlman** -- *Vice President of Investor Relations, Treasurer*

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

**Operator**

[Operator signoff]

**Duration: 0 minutes**

## **Call participants:**

**Kate Pearlman** -- *Vice President of Investor Relations, Treasurer*

**Marvin R. Ellison** -- *Chair, President, and Chief Executive Officer*

**Bill Boltz** -- *Executive Vice President, Merchandising*

**Joseph McFarland** -- *Executive Vice President, Stores*

**Brandon Sink** -- *Executive Vice President, Chief Financial Officer*

**Simeon Gutman** -- *Analyst*

**Marvin Ellison** -- *Chair, President, and Chief Executive Officer*

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**Christopher Horvers** -- Analyst

**Chris Horvers** -- Analyst

**Scot Ciccarelli** -- Analyst

**Kate McShane** -- Analyst

**Robert Ohmes** -- Analyst

**Joe McFarland** -- Executive Vice President, Stores

**Robby Ohmes** -- Analyst

**David Bellinger** -- Mizuho Securities -- Analyst

**Zachary Fadem** -- Analyst

**Zach Fadem** -- Analyst

**Brian Nagel** -- Analyst

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