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# EDITED TRANSCRIPT

LOW.N - Lowe's Companies Inc at Goldman Sachs Global Retailing Conference

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**Katharine Amanda McShane** *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

## PRESENTATION

**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

Okay, everyone. Hello. Thank you for joining us. It's my pleasure to introduce Lowe's. We have Marvin Ellison, Chairman, President and Chief Executive Officer. Marvin, thanks so much.

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**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

Pleasure to be here.

## QUESTIONS AND ANSWERS

**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

For joining us today. I'm sure the #1 question you've been getting, you're still getting is on the macro. And we always appreciate your view. Can you maybe take us through what you're seeing today in terms of the housing market, what it has meant for your business and your view into next year?

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**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

Well, great. Well, first, it's great to be here. And on the macro, I want to speak to specific to home improvement because that's really the focal point for us. Overall, with housing, obviously, with rates up, turnover is affected and that's down. You look at home equities being still at record levels, which we think over the mid- to long-term is going to be positive for our space.

But for us, at Lowe's, the two more consistent demand drivers is home price appreciation and personal disposable income. And as I mentioned, our home price appreciation and equities are up significantly even in pre-pandemic comparisons. But on that personal disposal income, we're seeing that do-it-yourself customer, that DIY to be a bit cautious. And as a reminder, at Lowe's, 75% of our revenue is driven by the DIY customer and 25% by the Pros. Whenever that DIY customer becomes cautious, specifically on big ticket, it disproportionately affects us.

Having said all of that, we feel great about the medium- to long-term prospects of the sector and of our business. And we are making and have made really good investments in our business in IT infrastructure, in people, supply chain, online and technology that we believe that we're going to continue to grow share even in a home improvement market that is down mid-single digits this year.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

And I think it's probably fair to say, we've talked about this with a lot of other companies, that there's the macro piece and then there's the share of wallet piece. And obviously, home improvement was a big beneficiary of people staying in their homes during the pandemic and working on them. Can you talk a little bit about how you think the share of wallet trends have impacted your business? How much of it do you think is people reprioritizing spend versus getting a lot of projects done in the home that won't need to be addressed again in the next couple of years?

**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

So for us, when you look at that 75%, 25% DIY growth mix, the share of wallet for us is really being driven by strong performance in two businesses, and that's Pro and online. Even in a market that's down this year, we've had positive growth in online and in Pro. But our Pro customer is that small-to medium-sized Pro, we're not chasing the larger, more industrial Pro. That's not in our strategic viewpoint as of yet, but that small- to medium-sized Pro represents about [\$250 billion] (corrected by company after the call) in market share opportunity.

So as we think about share of wallet, we think about the ability in the last 5 years to grow our Pro penetration from 19% to 25%, so 600 basis points. So that tells us that we're growing share with that small to medium Pro, and we continue to grow online. When I arrived at Lowe's 5 years ago, our online penetration was about 4.5%. Now it's roughly 10.5%. So the growth is there as well.

We believe that even in a market where DIY discretionary large ticket is down, if we continue to grow business in online channels and with Pro, we can continue to outperform the market itself, and that's going to continue to contribute positively this share of wallet. And again, the differentiation I want to make is on the snapshot today versus what we think the medium and long term will be. We think the snapshot today is a little choppy because again, that DIY customer is not only being impacted by inflation and in some regards interest rates, but they're also investing in more experiences, whether that's travel or whether it's concerts and other things that we're all reengaging with coming out of the pandemic years.

And so we think that customer's cautious approach spending on large ticket is in large part due to that. But we think that's a short-term phenomenon that we're dealing with. And the medium- and long-term prospects of this business is really positive, and we're incredibly bullish on the outlook and where we think we're going to be as a company.

**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

And speaking of the small to midsized Pro, it seems like that business has been fairly resilient even given the macro pressures. Can you talk a little bit about what you're seeing just within the industry for that specific customer and what Lowe's is doing to cater to that customer to grow?

**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

So let me take you back in time. I mean we were in a position where those customers have shifted away from us because really, we had no strategic focus in any channel, online or in store, to serve those customers. And that was reflected in the fact that we had lost a lot of national brands. And that's a very brand-conscious and brand-committed consumer, and we just couldn't service them just from a basic fulfillment and inventory levels in our stores.

And so we took a methodical approach of first fixing the in-store environment with staffing, with what we call a job lot quantity inventories, meaning a depth of inventory that could actually support a job site project, in addition to making sure that we just had basic things like the ability to load when the customers showed up.

So that's the kind of the foundation. And then we took additional steps over the years like launching a loyalty program last year to create reasons to come back, to get a larger share of wallet and to get to more return business. We implemented a world-class [CRM] program just to give us better visibility of when the customer shops and how they shop. And we recently have a partnership with a gig network called OneRail that gives us same-day delivery capabilities in addition to job site fulfillment capabilities that we've built over time.

So when you think about all of that in addition to online tools that give them access to business resources and other benefits, that's consistent with our ability to grow the penetration from 19% to 25%. And we're really excited about the extension of our brand portfolio. More specifically, recently, we announced that Klein Tools was coming back to Lowe's after a 15-year absence. And in this specific brand is the #1 branded tool for electricians and HVAC professionals. And if you're trying to attract the Pro who is an electrician who works on AC units, you don't have this specific brand, you're not going to get the share of wallet that you want.

And so not only are we bringing this brand back after 15 years, but we're going to have the largest assortment of Klein Tools of any home center in the country. And that is only because a company like Klein can look at what we've done over the past 5 years to grow this business segment, and they want to be part of that growth. That's important, meaning the Pro growth, because it is required because we're feeling pressure on the DIY. But that DIY is 75%. And so that pressure is real.

And as you think about our performance this year, we're seeing that DIY pressure really starting in Q4 around the holiday season on that discretionary big-ticket spend and that kind of carried into this year, and we're continuing to manage that and we're trying to grow our Total Home business at the same time. But as a result of the DIY pressure result of Q3 being our challenging -- most challenging year-over-year comparison, we think that for the quarter we'll end at the bottom of our annual guidance from a comp perspective.

And we think that's indicative of the short run headwind of this sector, but we're also so incredibly confident in the investments we're making, and we're confident in the medium- to long-term view of this business. And we think that the investments in our Total Home Strategy and the demand drivers that we think will continue to pay dividends is going to make this a really important sector for the future, and we think it's one of the best sectors of retail that you can be in at this moment in time.

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**Katharine Amanda McShane** - Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst

And just to wrap up the thought on the Pro. I know there's been an intense focus there, especially on the national brand side like you mentioned with Klein. How much further do you have to go with any of the initiatives? Or are you at a place where you feel like the offering is right now for this Pro, and it's more just getting the message out to them?

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**Marvin R. Ellison** - Lowe's Companies, Inc. - President, CEO & Chairman

I think when you look at the \$250 billion market share opportunity for the small- to medium-sized Pro, we think that the flywheel effect of the investments we've made in service levels, brands, loyalty program, CRM, digital online channels, we think that flywheel will allow us to continue to take share in that specific segment. You're going to see us continue to improve our fulfillment capabilities. And you're going to see us continue to attract additional brands and create a broader assortment of existing brands.

So all of those things are a continuous process that we think will be, again, part of that flywheel effect that we'll continue to take share. And we have an expectation that we'll grow this Pro business 2x the market. And so whatever the marketplace, we think we'll grow 2x that for Pro. And whatever the marketplace is in home improvement, overall, we think we'll outperform the market, and we've done that so far.

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**Katharine Amanda McShane** - Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst

So moving back to DIY, which you've mentioned is where more of the pressure is. Big ticket categories is where we continue to hear. There's a lot of pressure. But now it's been maybe 2 years since we've hit some of the peak and at least some of the big ticket categories. And how should we think about a return to a more normalized demand environment for some of these products, such as like patio furniture?

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**Marvin R. Ellison** - Lowe's Companies, Inc. - President, CEO & Chairman

It's a really good question. I think for us, it's really about managing the near term. And what the near term is demonstrating to us is that the DIY consumer, although healthy, is cautious. And we think that cautious approach to big ticket is just driven by the concern that there may be something else looming. I think there is a more universal view that we've avoided a major recession, and we support that view.

And we believe that the homeowner is healthy. Unemployment is stable, but I still think there's some level of malaise and concern with the DIY consumer on big ticket just because of a lot of what I call noise and other concerns in the marketplace. Having said that, that customer is slightly pulling back based on the cautious approach you're taking to big ticket. We don't have a point of view as to when that inflection point happens,

but we're expecting that pressure to remain for the balance of the year. And we're hoping that when that pressure is removed and that customer regains their confidence, we're going to be well positioned to take share because we've made the investments, we have an incredibly strong balance sheet. And irrespective of the macro environment, we're going to continue to invest in our Total Home Strategy, and we're going to continue to make sure that we pull the necessary operational levers to run a really profitable and effective business.

So we don't have a point of view of when that inflection point on big ticket happens, but what we can express is that with 75% DIY penetration, when that big ticket is under pressure for DIY, it disproportionately impacts our business. It's one of the reasons why it's so important for us while we're dealing with the DIY headwind to continue to grow the Pro and the online segment to try to gain some benefit in the marketplace. And as I mentioned earlier Q3 for us is our toughest year-over-year compare versus last year. And so it puts a little bit more pressure on us this quarter.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

One other bright spot that we haven't talked about yet is appliances. Lowe's has been outperforming the broader market for appliances the last few quarters. Can you talk about what the company is doing to continue to take market share in this category? Is it -- does it have to do with your delivery, because that's changed? Or is there something more happening here in order to drive this business?

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**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

We're incredibly excited about our market share position in appliances. We exited last year with appliances being roughly 14% of our total sales revenues. So it is a big part of our business. Part of the reason why we have taken market share is a combination of things. Number one, we've dedicated the most space. We have the widest selection of brands. And we have now the ability of market delivery to deliver next day in every market where we have market delivery currently in place. And we'll have the entire company, for all intents and purposes, built out on market delivery by the end of the fiscal calendar.

So we think all of those initiatives and all of those advantages continue to play in our favor, not to mention, we've been able to create a really seamless and customer-friendly experience buying appliances online, and that was always not the case. But there's been a lot of work to get us there. That's the good news with appliances. The challenging news with appliances is when that business is not robust, again, the disproportionate pressure is felt by us because of the 14% penetration of the overall revenue and the fact that when we think about interior big ticket, it almost always starts with appliances.

And so that business has to remain healthy for us in order for us to have the top line growth that we want, and we're definitely dealing with more headwinds in that big ticket discretionary space this quarter and this year than we have in the past. But we do believe that's a temporary snapshot in time, just based on some of the cautious consumer approach to big ticket that I spoke of earlier.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

If I could pivot a little bit to your localization strategy. That's something newer. I think you've been talking about with your updated rural framework now rolled out to about 300 stores. Can you talk about the importance of focusing on more rural product assortments, what types of products you've added into the store? And what competition will look like for you there?

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**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

Well, this is a strategy that's near and dear to my heart. I grew up in a rural environment. And I typically will go home and visit my dad, and we have a lot of stores in that surrounding area. To the dismay of some of my executives, and I spent a lot of time in those stores wanting to understand if we're serving those customers well. And what my informal surveys and now ultimately formal surveys taught us about the rural customer is that they were having to shop multiple stores to get basic things that they wish they could get just at Lowe's.

They would shop us for home improvement, but if they needed something for their farm or small ranch, they would have to go to other retailers to get those things. Whether that's feed or whether that's seed or whether that's workwear or whether that's more tools for hauling and loading.

And so we just decided to take a step back, look at the space productivity of these rural locations and actually question, are there categories we could exit out of that are not very productive? And could we replace them with more productive categories so that we could give that rural customer more of a one-stop shop or they didn't have to shop in multiple retail formats to get what they needed?

And the early results are very positive. And so we're very happy with what we're seeing with our investment in workwear with our partnership with [Carhartt] and others, Petco store-in-a-store concept, that's been resonating really well. ATV vehicles and many, many other things that we're doing that have resonated well. The expectation for us is to grow share of wallet, increase number of business and transactions and increase average ticket size. And we're really pleased with what we're seeing in the early stages of this.

And as much as we talk about the importance of localization, to have a U.S. store footprint of over 1,700 stores, we're still not as localized as we would like to be, which gives us incredible upside because we know that ultimately, the great unlock for us is to continue to improve the productivity of our space in our stores. That's going to be a great benefit to our return on invested capital. And that's something that we're very committed to. And we think that there's a lot of runway in front of us to continue to drive benefit from the space and how productive that space is, not only from an inventory velocity, but also from just what we sell, how we sell it and how we engage with the customers.

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**Katharine Amanda McShane** - Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst

And do you think that leads to an opportunity one day down the road for more stores? Or is it really just about making the existing fleet more productive?

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**Marvin R. Ellison** - Lowe's Companies, Inc. - President, CEO & Chairman

It's a really good question. For Lowe's, we see the long-term benefit to our shareholders and to ensure that we are creating the best return for our invested capital driving productivity from existing stores. Now don't get me wrong, we will open a handful of stores a year to address geographic voids or to put stores where population density has shifted. Or in some cases, to relieve the sales pressure of higher-volume stores, but where we see no realistic plan to lean into new store growth is a big capital spend. The hurdle rates are high, and we don't think it's the best investment for our shareholders. But we do think that there is tremendous opportunity for us to drive space productivity and to get a lot more throughput through our existing stores.

One of the great things about leveraging your Pro business in our environment where we're at a 25% penetration is that the fixed cost is already in place in most stores that serve the Pro customer. And as you ramp up the sales of that specific channel, you don't have to increase your expense base in the store. And so you lever the revenue significantly, and it's very accretive from an operating income perspective.

So again, that's just a more long-winded way of saying, we think the greatest benefit to drive return on invested capital is store productivity of existing store fleet, and you'll see us open very few new stores with the exception of strategic infills, and we think that will be, again, a handful of stores in less than a year.

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**Katharine Amanda McShane** - Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst

Just focusing a little bit more on just productivity and managing costs. You have a merchandising PPI initiative. And I thought maybe where we could spend some time is the -- your focus on reducing costs and some of the work you've done regarding direct imports and the cost optimization tools that you're using. So could you maybe walk us through where we are in that initiative and how this contributes to your still positive operating margin expansion?

**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

It's a great example of one of the benefits of our 5-year transformation. So I think the first data point I'll share is that in 5 years, we've improved operating margin of over 500 basis points. And part of that has been just building the right tools, creating the right discipline and making sure that the investments that we're making are investments that provide productivity not only in the store environment, but in merchandising.

And when you think about merchandising, one of the areas that we're excited about unlocking is building up a team supported by finance and merchandising that provides incredible insight to everything we buy and getting unit cost of all the components that go into the products we buy. It is -- it was not uncommon, 4 or 5 years ago, that whenever there was a cost increase coming from a supplier, we were first in line to get it because we had no data to determine if the cost increase was legitimate or not because we had no visibility to component costs, and we had no real mechanism or analysis or any processes determine that.

We're now at a very robust level where it's not uncommon for a supplier to come, recommend a cost increase. And before they leave, we have a cost decrease because our data set is so strong in our analysis is so in tune with -- with all the components. And not only that, but manufacturing costs and supply chain costs. And so we think that is a gift that we'll continue to give. And it's 1 of the reasons why we look at next year and we don't see any real concerns about inflation or deflationary impacts to our business. But again, that is an ongoing process of just managing cost.

Also, as we think about ramping up private brands, we think it's important because with our DIY penetration, we can serve that customer very effectively with a private brand versus a national brand because of some of these decor-related categories. Customers are rather brand-agnostic. And so that gives us a chance to take control of design, manufacturing, and then we can get a greater margin rate for the same item.

But conversely, we want to make sure that we're leaning into national brands for the Pro customer because they are very brand loyal. And so that's the converse. And that was one of the big mistakes the previous management team made is not understanding the brand preferences of the DIY versus the Pro segment. But we think the private brands, specifically for DIY decor categories, will give us also margin and operating margin benefit over the long term.

And also just the modernization of our supply chain is also very tied to merchandising and how we flow products and being able to have great visibility from manufacturing until it gets to -- to the shelves of the store. And then you take all that and then you put in a modern price management system, something that we've been working on for 3.5 years, that really would give us the ability to price effectively not only versus the competition, but understanding that price variance is required to drive customer demand.

So all of those things are a work in progress. And that's why when I said recently on our earnings call, that even though we've improved operating margin by over 500 basis points in 5 years, we still have a line of sight for continuous improvement. My CFO, Brandon Sink and I have a road map of initiatives that are multiyear that are in development from an IT investment and from an execution standpoint that we know the benefit that's going to be coming out of those initiatives over a time horizon. We call it our perpetual productivity improvement plan, or PPI. And not only does that perpetual productivity improvement exist in store operations, but it exists in merchandising. It exists in supply chain. It exists in all the functions of our company. And that gives us a line of sight that we can continue to drive operating margin improvement, and that's something that we're very committed to.

And even in an environment where we have revenue pressure like we have right now, we still have a high degree of confidence that the investments we've made will give us the ability to drive the right level of profitability and give us the right operating model so that we can compete and we can perform really well irrespective of the macro environment.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

Okay. Thank you. I wanted to ask about [shrink]. This is an issue that we'll hear from a lot of retailers, but it's not one that Lowe's has flagged in a meaningful way. So could you maybe talk about some of the differences maybe that you're dealing with or why you've been able to avoid maybe some of the higher costs that we've been seeing out of other retailers?

**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

Well, it's one of the areas of the business that we're most pleased with. As a major big-box retailer, you're right, we're one of the few who've not flagged shrink as something that is having a material impact on gross margin or operating profit. And it's not by accident. I mean, we've invested quite a bit of technology at different parts of the business in front of the customer and behind the scenes to help us to manage this, and we take a unique and differentiated way.

Quite candidly, we think that our store footprint, being a percent of our sales, being rural, remote and suburban, also plays a positive benefit because those stores not only are at a different cost model to operate when you look at physical plant, when you look at labor costs, but also when you look at shrink. And so that gives us a little bit of a benefit just based on where the geographic portfolio of our stores outline.

And also, we have a dedicated asset protection team that I think is best-in-class in retail. They have great partnerships with law enforcement communities and the like. And we spend a lot of time on associate training. Having spent my entire adult life in retail, at every level, the one thing that I understand clearly is that the greatest deterrent for any debt activity is effective customer service and making sure that you have the right type of merchandising display.

So when you take all of those things together, they've been incredibly beneficial to us. Even in the second quarter, our most recent quarter, we talked about how, from a margin rate standpoint, we had really no negative benefits as shrink. As a matter of fact, our margin rate was up year-over-year, and we had very strong operating margin performance. And we don't anticipate that shrink is going to be a material negative impact to our business for the balance of this year. And again, it's a difficult environment. I've never seen anything like it, and we're incredibly pleased that we're able to have a differentiated performance relative to the other major retailers.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

All right. Thank you. We're at the point where we're just asking everybody for questions at present with us. You've been at this conference so many times. You know. First, we want to ask about the health of the consumer. Just -- do you think the consumer is facing more headwinds, less headwinds or about the same going into '24?

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**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

What we would say is, based on what we're seeing right now, and I can speak specifically to 2023, we think the small- to medium-sized Pro is relatively healthy. And we think the DIY consumer is cautious. And that cautious DIY consumer is more geared towards large ticket interior projects.

And for us, as I said earlier, that impacts our appliance business. And so as we look at 2023, we think the cautious DIY consumer on big ticket and the Pro business remains relatively steady. We did a survey recently, and 75% of our Pro said that their back project backlog is consistent with last year. So that equates to a pretty steady, healthy segment. But that's only 25% of our business.

As we think about 2024, it's really early for us to make that call. We want to work our way through the holiday season. That gives us a really good indication of trends going into 2024. But specifically to what we're seeing now and what we think the back half will look like, we see steady performance of the Pro, and we see cautious spending on large ticket for the DIY.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

And then just part B of that question is trade up or trade down into '24. I think what you've said in the past for '23, you haven't really seen a trade down within the stores. That's something you expect to stay the same?



**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

We haven't seen what I would call a material trade down, but what we're seeing is, again, a big ticket avoidance. Now the great thing about home improvement is that projects are typically delayed, not canceled. So even though we're seeing some cautious spending on DIY discretionary big ticket, we have incredible optimism on the medium- to long-term because we know those projects ultimately are going to be executed, and we want to get a disproportionate share of that when it happens. So it's not necessarily a trade down as much as it is a cautious purchasing behavior for interior discretionary big-ticket for DIY consumers.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

Okay. Our second question is on share of wallet, which we talked about earlier. So we'll skip that one. With regards to pricing, Brandon, I think, has talked about this in the past, but as we look into '24, how do you anticipate pricing to look? Will it be higher, lower, about the same?

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**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

As we look at the balance of this year, starting there, we don't think that you're going to see material impact to pricing relative to inflation or deflation. Because as a reminder, this year, in our home improvement channel, we dealt significantly with lumber deflation. And we think that we'll have maybe 75 basis points of lumber deflation negatively impacting comp sales in the third quarter. We think that's going to be virtually flat in the fourth quarter. And for '24, as I sit here today, we don't see any material impact to pricing relative to inflation or deflation, not within our specific home improvement segment.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

Okay. Thank you. And then the last question is about destocking. I mean, really, over the last 3 years, we haven't really seen any major fluctuations in Lowe's inventory, good or bad. So what -- where are we in the process of getting back to normal with the supply chain, with your in-stocks? And just what is your view on inventory going forward?

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**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

We feel good about where we are on managing our inventory. And again, home improvement is a little unique. We have a very small percent of what you would describe as fashion or seasonal inventory, which means that we have a more limited markdown risk in our segment versus, say, department store.

Having said that, our focus is on inventory productivity. On turns, and making sure that we have key categories that we're never out of stock. And that specifically is for those Pro customers, that time is money. And the last thing they want is to have a purchase -- a desired purchase where the insight levels are not where it should be. So as we focus on productive inventory, inventory turnover and being in stock in key categories, we think that the health of our inventory will continue to improve and we feel really about our current position.

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**Katharine Amanda McShane** - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

Okay. Thank you so much for joining us today.

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**Marvin R. Ellison** - *Lowe's Companies, Inc. - President, CEO & Chairman*

Great to be here. Thank you.

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