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BBY.N - Q3 2025 Best Buy Co Inc Earnings Call

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OVERVIEW:

Company Summary

REFINITIV

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to Best Buy's third quarter fiscal 2025 earnings conference call. (Operator Instructions) As a reminder, this call is being recorded for playback and will be available by approximately 1:00 PM Eastern time today. If you need assistance on the call at any time, please press star zero and an operator will assist you.

I will now turn the conference over to Mollie O'Brien, Head of Investor Relations.

Mollie O'Brien - *Best Buy Co Inc - Head of Investor Relations*

Thank you and good morning, everyone. Joining me on the call today are Corie Barry, our CEO; Matt Bilunas, our CFO; and Jason Bonfig, our Senior Executive Vice President of Customer Offerings and Fulfillment in Canada.

During the call today, we will be discussing both GAAP and non-GAAP financial measures. A reconciliation of these non-GAAP Financial measures to the most directly comparable GAAP financial measures and an explanation of why these non-GAAP financial measures are useful can be found in this morning's earnings release which is available on our website investors.bestbuy.com.

Some of the statements we will make today are considered forward-looking within the meeting of the Private Securities Litigation Reform Act of 1995. These statements may address the financial condition, business initiatives, growth plans, investments and expected performance of the company and are subject to risks and uncertainties that could cause actual results to differ materially from such forward-looking statement.

Please refer to the company's current earnings release and our most recent 10-K and subsequent 10-Qs for more information on these risks and uncertainties. The company undertakes no obligation to update or revise any forward-looking statements to reflect events or circumstances that may arise after the date of this call.

I will now turn the call over to Corie.

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

Good morning, everyone, and thank you for joining us. Today, we are reporting an in line operating income rate for the third quarter on softer-than-expected sales. We are proud of our continued ability to maintain our profitability even if sales are slightly lower than expected.

On revenue of $9.4 billion, we delivered a non-GAAP operating income rate of 3.7%. We drove strong year-over-year gross margin rate expansion of 60 basis points, largely due to improvement in our membership and services offers. Our SG&A spend was in line with our expectations.

Our comparable sales declined 2.9% compared to our guidance of down approximately 1%. Our sales performance was impacted by overall softer-than-forecasted customer demand during September and October. We attribute this to a combination of overall ongoing macro uncertainty, customers waiting for deals and sales, and distraction during the run-up to the election, particularly in non-essential categories.

The expected lower demand between sales events, but the impact was even steeper than we estimated. In the last few weeks, as the holiday sales begun and the election is behind us, we have seen customer demand increase again.

From a category perspective, we drove comparable sales growth in computing, tablets and services. This growth was more than offset by declines in appliances, home theater and gaming. We again delivered strong results in our domestic computing and tablet categories, which together posted comparable sales growth of [5.2%] over last year.

The year-over-year growth rate for laptops specifically increased to 7% in the third quarter. With our market position, expert sales associates and compelling merchandising, we continue the capitalize on demand driven by customers' desire to replace or upgrade their products combined with new innovation.

As we expected, customers remain deal focused and attracted to more predictable sales moments. Similar to prior quarters in this environment, many categories including major appliances (technical difficulty) were very promotional in pursuit of stimulating interest and sales.

We continue to be targeted and thoughtful regarding where and when we made our promotional investments, strategically balancing profitability and sales. Our omni-channel operation cited strong support for our Q3 online sales of $2.7 billion, which comprised 31% of domestic revenue.

Almost 60% of our packages are delivered or available for pickup within one day. [The percent] of digital sales picked up by customers has been increasing steadily over the past few years and is now approximately 45% of domestic digital sales with more than 90% of these orders available within just 30 minutes.

Our paid membership program continued to drive positive contributions to our results as we grew the base of members and the impacts from the changes we made to the program last year once again drove strong gross profit rate expansion.

Overall, we are managing well what we can control in what remains a volatile environment. I am grateful to hard work and dedication to our customers that our team members across the company show every day.

I am proud of the culture we have built at Best Buy, and I'm pleased to report that our turnover rate is the lowest we've seen in over three years and lower than it was at the end of fiscal '20. Additionally, our company engagement score as measured by our employee surveys was already at the global benchmark level earlier in the year and increased in the third quarter.

As we look to the rest of the year, we are excited for the holiday season. We feel well positioned with compelling deals, inspirational merchandising and competitive fulfillment options. We have a unique position that deleverage at this time of the year. We will, of course, have deals across a wide range of price points.

At the same time, our promotion and over-indexes on offering great price for the latest innovation and premium products and assortment that not everyone has.

Let me provide a little more detail on our holiday plans. From a timing perspective, we kicked off our Black Friday sale a week earlier this year, starting last Thursday, November 21. We also brought back the concept of Doorbusters, which drop every Friday between November 8 and December 20, and on the Best Buy app, bestbuy.com and in our stores.

As a special perk to our paid members, they get early access to the Doorbusters every Thursday before they are available to everyone. It's early in the holiday season, but we are encouraged by how our Doorbusters and other Black Friday sales are resonating with customers thus far.

In fact, our enterprise comparable sales for the first three weeks of November are up approximately 5% over last year. To help customers find the perfect gifts, we're bringing back the holiday gift (technical difficulty) section on bestbuy.com, a one-stop resource for the hottest gift ideas and curated gift list with something for everyone, from crafting and self-care to traveling and gaming.

And in our app specifically, this year, we have an AI-powered gifting experience called the Best Buy Gift Finder. Customers can have an interactive exchange to help guide them to the perfect gift they might not have even considered or knew that Best Buy offered.

We also have our Yes, Best Buy sells that section on our website, where customers can find fun and unexpected tech like electric scooters, toys and collectibles, golf tech, grills, electric outdoor power tools and so much more. For even more gift inspiration, we created more than 30 videos to help customers discover must-have tech this holiday season on our Best Buy YouTube channel.

In our stores, customers will experience the magic of Texas holiday with new merchandising displays and of course, expert help as they need it. For example, customers can see XXL TVs, which are over 97 inches at more than 700 stores. They can also interact with Copilot+ PCs, the new Oura Ring, Ray-Ban AR glasses, gaming computers, the latest Quest VR systems, new over-ear headphones and so much more.

Our stores also offer the strategic advantage of convenience in a shorter selling season, both for in-person shopping as well as our fast and easy buy online, pick up in store. Of course, we have a very comprehensive trade-in program that we will highlight throughout the holiday to help customers more easily get new tech.

For example, customers can save $600 by trading in their tablets or up to $900 trading in their phones. We also have exclusive SKUs in a variety of giftable categories, including TVs, monitors, gaming and headphones. We continue to have exclusivity within Copilot+ laptops with about 50% of 60 SKUs retail exclusive to Best Buy.

Finally, our new branding is resonant in all our communication and marketing this holiday. To highlight our tech and our positioning, our new branding is centered on creating customer experiences that inspire curiosity and enable discovery and includes asking our customers what if as well as a new tagline, Imagine That.

This branding reflects the role that Best Buy, and our amazing associates play in our customers' research and purchase journey, and our training is also focused on bringing these experiences to life. While this is not an instant evolution, we believe our customers are already taking note as we are seeing satisfaction improvement in the excitement aspect of their experiences.

Even though they have been prepping for holiday, of course, we have continued to execute our strategic plan and priorities for the year. These have been built to sharpen customer experiences and industry positioning, while also maintaining our profitability in this still uneven environment.

As a reminder, our fiscal '25 priorities are, one, invigorate and progress targeted customer experiences. Two, drive operational effectiveness and efficiency. Three, continue our disciplined approach to capital allocation. And four, explore pilot and drive incremental revenue stream. I would like to provide some highlights of our progress.

We have initiatives targeting customer experiences across our digital and store channels. We are encouraged by the continued material year-over-year improvement in our relationship NPS, which tracks consumers' likelihood to recommend Best Buy.

We have been very focused on improving and refreshing our app and small view experiences, including enhanced personalization, new features like digital wallet, dealers, and the Gift Finder I just referenced, along with a more streamlined checkout process and faster content loading times.

I'm pleased to report we have both higher customer ratings for our app and growth in active users. This is an important way to engage our customers on their entire shopping journey as of course, their mobile device is always with them. Our data shows that customers who use our app frequent us more often and thus spend more.

Last quarter, we launched a market-leading new experience for our in-home delivery and installation customers. On the day of their appointment, customers can digitally track the live to-the-minute ETA of their in-home delivery and installation.

More than 60% of customers are engaging with the tracking and the feedback has been overwhelmingly positive. It was rated five stars by more than 90% of survey responders. Not only is this a great experience for customers, it is already starting to lower cost by reducing calls to our customer service teams.

In Q3, we added the capability for customers to access this ETA view from their locked mobile phone home screen. Today, we are excited to announce our latest enhancement, scheduled parcel delivery. We are expanding our small product shipping offerings to allow customers to select a specific two-hour delivery window up to seven days out.

This provides customers increased convenience, confidence and control of their delivery. It's currently live in a portion of the US market, and we expect it to roll out more broadly next year.

From a store experience perspective, we have largely completed the refreshes to our store portfolio for the year so we can focus on the holiday season with minimal disruption to our physical stores. Not every store was touched in the exact same way, of course. But for many, we optimized and refreshed mobile phones, headphones, smart home and digital imaging, and created new experiences in tablets and monitors.

In the areas completed during the second quarter, we continue to see related sales improvements, particularly in monitors and digital imaging. We also added a new merchandising solution in hundreds of stores. This is a modular experience that will transition more frequently to provide vendors the opportunity to create a branded stage for new technology solutions and innovation, and it enables greater flexibility to spotlight new brands and products during certain time frames, like the holiday season.

For example, currently, we are featuring new products from well-known brands like Lenovo, Asus, Sonos and Samsonite, along with new innovation from emerging brands like Whisker, Greenworks, Backbone and The Ridge.

Consistent with the past several years, we continue to rationalize our store portfolio. This year, we closed 12 traditional large-format stores in [APAC]. We have also opened (technical difficulty) stores, including four Best Buy outlets and two new stores we just opened in the last few weeks.

Our new Bosman location is unique and that it has about 15,000 square feet of selling space with the computing department anchoring the front of the store. It also has a robust home theater presence, a major appliances department and Geek Squad Precinct, as it is in an isolated retail node 140 miles from the nearest Best Buy store in billings.

In Kansas City, Missouri, we are placing a previously closed larger store with a smaller store format of roughly 12,000 square feet of selling space. This store was designed to complement existing locations in the micromarket. And as such, has a more modest presence of major appliances, and will also utilize nearby stores for Geek Squad repair instead of having on-site capabilities.

From a store labor model perspective, during the third quarter, we largely completed the rollout of dedicated expert labor in our computing, home theater and major appliances departments in hundreds of our stores.

In addition, as we mentioned last quarter, we are seeing our vendors expand their labor investments in our stores, including Samsung, Verizon, AT&T, TCL, LG and others. We've be adding labor in our stores is a highly productive way for many of our vendors to interact with qualified traffic.

In fact, we recently deployed new mobile experiences in hundreds of our stores. Depending on the store, either AT&T or Verizon is staffing the mobile department, assisting customers in a fast and seamless way by directly leveraging their own experts and proprietary carrier technology systems. We are encouraged by the initial results in these stores.

As I take a step back across our business, this year, we are reinforcing our experiences to capitalize on demand we expect from the confluence of replacement, upgrade and innovation in the coming years. While the environment remains uncertain, we are encouraged by many areas where we can see the results of our actions. For example, in computing, the investments we made in associate training and digital and store experiences are helping drive growth and share in the category.

The merchandising, inventory and fulfillment investments we have made in TVs are driving strong growth in XXL TV. Here, we are also leveraging our unique Geek Squad capabilities to offer free installation. Supporting all these examples is our new branding and elevated marketing spend that is driving increased traffic and awareness. We saw particularly strong results from the back-to-school marketing campaigns in Q2 and Q3.

We continue to make progress on our second key priority of our fiscal '25 strategy, which is to drive operational activeness and efficiency. Much of what we are doing to improve the effectiveness of our customer and employee experiences also generates efficiencies.

Last quarter, we held up the evolution of our labor model as a great example of where we are constantly driving customer experience improvements as well as effectiveness. It is how we have kept our labor rate flat as a percent of sales through the last few years as we have experienced revenue declines, and it is how we expect to hold that rate as revenue grows over time.

Of course, we also continue to leverage analytics and technology to achieve efficiencies. For example, because we use AI to route our in-home delivery installation trucks, we can drive more efficient scheduling and introduce a new and improved customer in-home delivery and install experience as I mentioned earlier.

We are also, as you would expect, leveraging Gen-AI cogeneration and shared resources for our engineers across the company to help us enhance our overall tech development effectiveness. Customer support is another important space where we are activating on many areas of opportunity.

For example, we are using an AI-powered virtual assistant that can help 60% of our chat users without the need for a live customer support person. During the third quarter, we began rolling out this capability to our entire IVR phone systems, increase the likelihood customers can get their questions answered without having to wait for a live agent. And we are leveraging text analytics to create real-time alerts, directing us to a potential operational or promotional issue.

We are, of course, closely observing feedback as we implement these capabilities to ensure we are maintaining a good experience for our customers. And overall, we are seeing customer satisfaction improvements in our call center experiences. Our reverse supply chain capability is another important ongoing driver of efficiency and savings.

In addition to adding new outlet stores this year, we just launched a new section on our website that combines open box, refurbished and clearance product for the first time. We are seeing material sales growth in these products. And while it is early, we believe these digital experiences are helping.

Our third key priority for the year is to continue our disciplined approach to capital allocation in this environment. Our approach has remained consistent. We first prioritized investing in the business and continue to expect our enterprise capital expenditures for fiscal '25 will be about $50 million lower than last year at approximately $150 million.

Second, we remain a premium dividend payer. And third, we returned the remaining cash to shareholders through repurchases. Our fourth key priority for fiscal '25 is to explore opportunities that leverage our scale and capabilities to drive incremental profitable revenue streams over time.

Of course, this includes our collaboration with Bell Canada to very quickly expand our physical presence and drive incremental profitable revenue. In a little over five months, we have completed the transformation and rebranding of 167 small-format consumer electronics retail stores across Canada.

These stores, previously known as The Source, a wholly owned subsidiary of Bell Canada, were rebranded as Best Buy Express. In this collaboration, we are providing a curated CE assortment and Geek Squad services, as well as supply chain, market and e-commerce.

Bell is the exclusive telecommunication services provider and is also responsible for the store operating cost of the partnership. We have expanded our presence in malls and in smaller and midsized communities, reaching 61 brand-new markets for Best Buy Canada. I am proud of how quickly our teams have implemented the partnership.

Also while this is early, we are encouraged by the positive feedback from both customers and employees. A longer-term opportunity we are working on is marketplace. We have established growing third-party online marketplace in Canada, and we are planning to launch one in the US targeting mid next year.

We believe that as the trusted leader in CE, we have an opportunity to leverage our positioning and assets to build a differentiated digital marketplace platform, thereby bringing our customers access to much more expansive assortment and new categories.

In addition, sellers and advertisers will have an additional avenue to increase their reach and build their brands leveraging our qualified traffic. And we are continuing to make progress on other opportunities, including Best Buy Health, Best Buy Ads, which is our retail media network, and Partner+, our vendor supply chain program.

In summary, we believe we are executing well against what we can control and setting ourselves up for future growth. As we expected, we are seeing increasing stabilization in our industry this year, it's just not as linear as we had expected when we entered the year.

As we said last quarter, we see a consumer who is seeking value and sales events, and one who is also willing to spend on high price point products when they need to or when there is new compelling technology. Thus, we continue to balance our optimism and industry and our positioning with a pragmatic approach to likely uneven customer behavior going forward.

Therefore, we have adjusted our Q4 comparable sales outlook to be in the range of flat to a decline of 3%. The high-end of the range is a sequential improvement in comp sales trends that assumes the computing category continues to deliver strong growth and other categories show improved trends during the value-oriented holiday season.

We are maintaining our full year non-GAAP operating income rate guidance in the range of 4.1% to 4.2%. This compares to last year's 4% on a 52-week basis. We are the largest CE specialty retailer with a unique range of product assortment and expert services to help our customers discover how unexpected technology solutions can bring to life what matters to them.

We believe we are putting ourselves in the best position for fiscal '25 and beyond. As our industry returns to growth, we expect to grow our sales and expand our operating income rate.

I will now turn the call over to Matt for more details on Q3 financial performance and our outlook.

Matthew Bilunas - *Best Buy Co Inc - Chief Financial Officer*

Good morning. Let me start by sharing a few details on our third quarter results. Enterprise revenue of $9.4 billion declined 2.9% on a comparable basis. Our non-GAAP operating income rate of 3.7% declined 10 basis points compared to last year.

Non-GAAP SG&A dollars were approximately flat to last year while increasing 70 basis points as a percentage of revenue, partially offsetting the unfavorable SG&A rate was a 60 basis point improvement to our gross profit rate.

Our non-GAAP diluted earnings per share decreased 2% to $1.26. By month, our comparable sales were approximately flat to last year in August before declining roughly 4.5% in both September and October. Compared to the outlook we shared entering the quarter, our non-GAAP operating income rate of 3.7% was flat to our expectations.

Our overall gross profit rate was better than expected which was primarily driven by favorable product margins.

SG&A dollars were slightly favorable to our outlook entering the quarter primarily due to lower incentive compensation but unfavorable is a percentage of revenue due to the softer revenue performance.

Next, I will walk through the details on our third quarter results compared to last year. In our domestic segment revenue decreased 3.3% to $8.7 billion driven by a comparable sales decline of 2.8%. The overall blended average selling price or ASPs of our products was once again higher than last year.

The growth was primarily due to an increased mix of units coming from higher ticket items such as laptops and a lower mix of units coming from lower ticket categories such as movies. International revenue of $748 million decreased 1.6% versus last year, primarily driven by a comparable sales decline of 3.7% and the negative impact from foreign exchange rates.

These items were partially offset by revenue from the Best Buy Express locations that have opened during FY25. Our domestic gross profit rate increased 70 basis points to 23.6%. The higher gross profit rate was primarily driven by improvement within the services category which includes our membership offerings. This was partially offset by lower credit card profit sharing revenue and lower product margin rates.

Our international gross profit rate increased 40 basis points to 22.5%. The higher gross profit rate was primarily due to improved performance in our services category.

Moving to SG&A, where our domestic non-GAAP SG&A was essentially flat to last year. The most notable puts and takes were higher advertising expense which was partially offset by lower incentive compensation. Year-to-date, we have returned a total of $892 million to shareholders through dividends of $607 million in share purchases of $285 million.

Let me next share more color on our outlook for the year. Starting with our thoughts on the fourth quarter. From a topline perspective, we now expect our fourth quarter comparable sales to be in the range of down 3% to flat.

From a major category standpoint, we expect continued growth in computing and services and improved trends in other categories at the high end of our guidance. On the profitability side, we expect our fourth quarter non-GAAP operating income rates to be in a range of 4.6% to 4.8% which compares to a rate of 5% last year.

Last year's fourth quarter included an extra week, which we estimate added approximately $735 million in revenue and provided a benefit of approximately 40 basis points to our fourth quarter non-GAAP operating income rate.

Moving to gross profit. We expect our fourth quarter gross profit rate to improve versus last year, but at a lesser degree than we reported for the third quarter. There are three primary items we expect to impact the fourth quarter differently than the third quarter when comparing to last year.

First, although it is still a benefit compared to last year, the improvement in our services category and membership offerings is less of a tailwind as it has been throughout the year. This is due to having fully lapped the changes to our membership offerings early this year. In addition, the services category is a smaller part of our overall sales mix in the holiday fourth quarter, which reduces the benefit on a weighted basis.

Second, the product margin rates are expected to be a larger pressure in fourth quarter than they were in the third quarter. And third, we expect the profit share on our credit card arrangement to have a neutral impact on our gross profit rate compared to last year, which is a sequential improvement from last quarter.

Moving next to SG&A. The high end of our fourth quarter guidance assumes SG&A dollars are lower than last year. The decrease is primarily driven by having one less week this fiscal year, which we estimate to be approximately [$90 million].

Excluding the benefit from the extra week, the high end of our guidance assumes SG&A dollars grow versus last year. The most notable drivers are higher advertising and technology expense which are expected to be partially offset by reduced incentive compensation.

Let me provide more details on our updated full year fiscal '25 guidance which incorporates the color I shared on the fourth quarter and is the following. Revenue in the range of $41.1 billion to $41.5 billion. Comparable sales decline of 2.5% to 3.5%. Non-GAAP operating income rate in the range of 4.1% to 4.2%. A non-GAAP effective income tax rate of approximately 23.5%. And non-GAAP diluted earnings per share of $6.10 to $6.25.

Our full year gross profit and SG&A working assumptions are still very similar to what we shared last quarter. And some of the key callouts are the following. We believe our gross profit rate will now expand by approximately 40 basis points compared to last year.

The high end of annual guidance now assumes Non-GAAP SG&A dollars declined by over $200 million compared to last year, which includes the following puts and takes. As I previously mentioned, the benefit of having one less week this fiscal year is estimated at $90 million.

Store payroll expense is expected to be approximately flat to fiscal '24 as a percentage of sales which results in lower SG&A dollars compared to last year.

Vendor support geography lowered SG&A by approximately $40 million in the first half of this year. Incentive compensation is now expected to be approximately $30 million lower than fiscal '24 to the high end of our guidance. Partially offsetting these earlier items, our advertising expense is expected to increase by approximately $50 million versus last year.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Peter Keith, Piper Sandler.

Peter Keith Keith - *Piper Sandler & Co. - Analyst*

Hey, thanks, good morning, everyone. I wanted to just first dig into the Q4 comp outlook for flat to down 3%. And how you constructed that outlook just considering the nice start to the quarter at plus 5%? Just help us understand the various puts and takes that you're thinking about as we progress into December and January.

Matthew Bilunas - *Best Buy Co Inc - Chief Financial Officer*

Sure. First of, I'd say there are a few factors this year that make the compares a little less straightforward. There's a shorter holiday season, there's a change to the promotional calendar timing, there's calendar shifts. I guess the main point is that trends have improved from September to October, and we can see the customer responding to our holiday sales and how we're positioned.

So the first three weeks represent also only about 20% of our total Q4 sales. And in our quarterly guidance, we're very cognizant of the fact that there are potential low point between the sales events, particularly in December.

And additionally, while we don't feel like the shorter selling season between Thanksgiving and Christmas impact total sales for the quarter as people generally have the same number of gifts they buy every year, it doesn't mean that the shape of the holidays spending patterns isn't going to be different.

So again, at the high end of our range, we would expect things like computing to continue to be strong and show improved trends. And at the low end, we would see some performance similar to what we saw in Q3.

Peter Keith Keith - *Piper Sandler & Co. - Analyst*

Okay. Thank you, Matt. And then I guess just a real-time topic on tariffs. Could you just update us on your sourcing exposure, where you are today with both China and Mexico? And then what are some of the mitigation efforts you're potentially thinking about for both your direct imports and also maybe working with suppliers?

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

Yeah. Good morning, Peter. I'll maybe just provide some broad color here. And I'd start with, obviously, we've worked with many administrations throughout the years and on this particular topic, in fact, and we'd like to ensure we try to continue to work on this topic going forward.

I'm going to start with, I think everyone knows, which is ours is an incredibly complex industry with incredibly complex supply chains. And I think at the end of the day, everybody in the industry believes diversification is a very good thing, but it is not easy.

We directly control very few of those supply chains. As you know, we are the importer of record on only about 2% to 3% of what's being brought in. And on the products we control, the vast majority of that manufacturing, we have moved out of China. The tariffs themselves are also incredibly complex depending on the rules used, whether or not there's invest to games, governmental involvement, what countries, what level, will it be a phased approach. So all of that adds to the complexity.

And as we talked about before, in terms of the level that (technical difficulty) Last time we have to, we said about [50%] of our cost was coming from China. And again, (technical difficulty) Mexico is actually the second largest and that's where those two stand, but particularly in our history, this ends up being really shared to some extent by best buy.

But I have to say, of course, it will also be shared by our customers. These are goods that people need (technical difficulty) higher prices are not helpful. And I think many external organizations (technical difficulty)

So again, we're going to work hard to make sure that we're educating as best we can on how our industry is impacted and make sure we do everything we can to keep prices right for our customers.

Operator

Scot Ciccarelli, Truist Securities.

Scot Ciccarelli - *Truist Securities, Inc. - Analyst*

Good morning, guys. So the sales improvement you cited so far in 4Q, is it possible to estimate much of that was driven by the earlier start to Black Friday? And then related to that, can you help us better understand the promoter environment just as consumers are much more value oriented at this point? We can see that across retail verticals, but what you're seeing. Thanks.

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

Yeah. Maybe I'll start with the question around Black Friday. I mean, I think the team every year does a really nice job. Looking back at the year, we jumped and saying what worked and what didn't and whatever else would we like to try based on the assets that we have at our disposal.

And I think the team felt pretty strongly and wanted to get an earlier start on providing great deals. Part of that because, as part of your question, which is we see a consumer who is definitely value-oriented, and we definitely see a strong promotional environment.

So against that backdrop, I think the team very wisely said we should start a bit earlier and then go back to some of the -- I must call it, retro, the kind of the older ways that we did things. Really exciting doorbusters, really exciting offers, being able to do some offers by our Drops technology.

But I think really trying to target the excitement and joy that people want this time of the year, but also with those great deals, great promotions, doing that across price points. And then also, like we said in the prepared remarks, doing it in places where we're really over-indexed, which is some of the more premium, some of the more creative technology, and it's where we can kind of carve out a sweet spot for ourselves.

Matthew Bilunas - *Best Buy Co Inc - Chief Financial Officer*

Yeah. I think going into Q4, we would expect the promotional environment to be similar to what it was all year long. All year long has been very promotional. Q4 will be no different. It's the most value-seeking time of the year. I think we are very well positioned. We've been investing in price. We expect to invest in price in Q4.

The only thing I'd note in promotionality is and you can see that happen a little bit in Q3, there seems to be a little inconsistency to elasticity because sometimes promotions work well in certain periods and then sometimes the same types of promotions work less well in other periods.

But during those value-seeking moments, we do see the promotionality taking hold. We've been seeing our price perception improve throughout the year, and we can see the promotions making that in sales. So we feel good about our position, feel good about promotionality, and we'll continue as we go into Q4.

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

And the last thing that I would just add to that is we have a variety of mechanisms that we can use to help drive value for the consumers. We talked a little bit about trade-in in the prepared remarks. We've also been seeing some success with the strategic use of promotional digital certificates that sometimes we can just pop into people's digital wallet.

And we can see that really particularly driving some of our online results, where we see customers redeeming them sometimes in categories that we don't typically see, like small appliances and gaming and some of the other ancillary really giftable categories. So I think the team is doing a beautiful job not just with kind of the traditional what you see in terms promotional pricing, but also the other add-ons and value drivers that we can uniquely offer our customers.

Operator

Anthony Chukumba, Loop Capital Markets.

Anthony Chukumba - *Loop Capital Markets - Analyst*

Good morning. Thanks for taking my question. So you talked about your laptop sales, and we obviously have the common computing and phones. But I was just wondering if you can maybe just comment a little bit on the performance of mobile phones and what you've seen in terms of, I guess, AI-optimized models like the iPhone 16?

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

So maybe I'll start, and Jason can add some color. Although, it was still down to last year, in Q3, our mobile phone trends did improve slightly versus Q2, and that was kind of across the assortment. It's hard to say, as you can imagine, exactly what's attributable to AI technology, and especially because a lot of that infrastructure and a lot of the improvements hadn't quite launched at the time of the launch within Q3. You didn't see some of those upgrades happen until towards the end of the quarter.

But I think in general, in the category, we're seeing curiosity about how their phone, how people's phones might develop into more of a virtual assistant or a partner with them. But I think a lot of that innovation is still in front of us.

Honestly, Anthony, I think we're just at the early -- and I would say this broadly about AI in general, we're kind of at the early stages of the continued advancement that we would expect. The good news is you're just seeing hardware that will be ready to use those advancements as they come to fruition throughout the next couple of years. Jason, I don't know if you have anything to add to that.

Jason Bonfig - *Best Buy Co Inc - Senior Executive Vice President of Customer Offerings and Fulfillment*

The other thing I would add is we're continuing to see the customer move into unlock phones more and more where they're purchasing the phone outright and then connecting the carrier that they're already on. We think that's a strong trend, and we're also seeing a lot of that focused on the more premium models, which obviously are the ones that support AI even better.

And then as Corie talked about earlier, we do have partnerships with both AT&T and Verizon in hundreds of stores, where they're there with additional labor to really capitalize on the trend as customers are coming in and asking questions as they're looking to upgrade to those newer models.

Operator

Steven Forbes, Guggenheim Securities.

Steven Forbes - *Guggenheim Securities - Analyst*

Good morning. Corie, I was hoping to maybe explore the profit improvement across services, maybe the higher level as we think out here to 2020 -- fiscal '26 and '27. So maybe a two part question.

I guess, one, are there any aspects of the recent improvement that you view as maybe at risk right or unsustainable, whether it be within the membership program across the sort of warranty aspect or really just in services in general?

And I guess, two, can you update us on how warranty revenue has trended this year? And any sort of preliminary thoughts on how we should be thinking about that profit stream into next year?

Matthew Bilunas - *Best Buy Co Inc - Chief Financial Officer*

So thank you for the question. Overall, the gross profit expansion in services this year has been driven by -- and membership is driven by a few things. First, we obviously made the changes in the program last year and we began to lap those at the end of Q2 this year. So where we had a certain offering -- we created another offering and we lowered the price of the total tech and created a total.

That also reduced the cost to serve that program. And so, while we're still seeing benefits of the change in the program after Q2 and Q3 and Q4 this year, we're seeing the benefit overall to start to slow down compared to where it was in the first part of the year.

And lastly, the improvements have also come from improvements in the stand-alone warranty business. If you think about going into next year, some of these improvements will obviously start to slow down and go away. The improvement of the cost to serve by the time we get to next year will likely have been already accomplished because we would have had those improvements all year long.

And so, when you get into next year, the compare will be pretty normal. So that probably won't be a driver of a lot of benefit next year in terms of services and membership. What could be a continued driver of improvement to the service membership is the warranty business has been doing well this year. Our attach rate has been increasing and that has been driving more standalone sales. You could imagine that could potentially increase next year as well. And so that's one area.

But overall, if you think about services and membership next year, I would think of the business not being too different from the enter trajectory going into next year. So still very healthy, still very strong and probably more to do with how the core business starts to improve.

So if the core product rate goes up, the services business should follow. And if we can drive more stand-alone business, that would obviously help the rate, but not probably the improvement that we're seeing this year.

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

Steve, I'm going to build on what Matt said, at that kind of highest level in terms of our operating income, there's always puts and takes. And I think the membership and services is one piece of it. I think on the whole as we go into next year, obviously, we're going to keep our eyes on anything that is a bit more out of our control, like a major disruption in supply chains or some of those kind of things.

But the puts and takes, in general, I think we feel pretty good about it. That's why even in the prepared remarks, we said as the industry returns to growth, our ongoing goal is to continue to expand those operating margins and structurally trying to put ourselves in position to do that.

We've talked a little bit about some of the layers of pressures that have been on the business, like inflation, like services spend, like the housing market, like the lack of innovation. You can see all of those kinds of starting to turn the corner here.

And so, I think that gives us some level of confidence in the topline as we head into next year (technical difficulty) increasing expansion in those rates as it relates to membership and services. But I also don't think there's anything structurally that makes us say it's going to massively pull back. I think we had been in a good position, given all the strategic investments that we've been making.

Steven Forbes - *Guggenheim Securities - Analyst*

That's super helpful. Thank you, both. And maybe a quick follow-up on the revenue contribution from Best Buy Express within the international segment. I think we can back into it via the color you provided, but any comment on the profitability of that revenue stream?

Matthew Bilunas - *Best Buy Co Inc - Chief Financial Officer*

Yeah. For this year, the profitability will be pretty neutral in terms of how much EBIT is contributing. There is some sales coming through, but there as you can appreciate some ramp-up costs as we're putting the locations in. As we get into next year, we would expect that to generate some improvement. But for this year, it's a pretty neutral impact.

Operator

Joe Feldman, Telsey Advisory Group.

Joe Feldman - *Telsey Advisory Group - Analyst*

Hi, guys. Thanks for taking the question. I wanted to follow up on, Corie, you gave some examples of some of the new store formats that you guys are playing around with. And I was just wondering, and maybe it's too soon, but I'm curious just how you guys are seeing the consumer respond to the stores? And are you getting what you would like out of them or you do have them?

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

Yeah. Thanks, Joe. I'll hit this in a couple of tranches. So we talked about kind of three different new stores that we were launching. One is our outlet strategy. And I think the outlet strategy, that we have more experience with. We have outlets already. We've expanded that. And that really supports the, we think, competitive advantage we have in being able to have refurbed, guaranteed product, open box products, especially in an environment where the consumer is looking for value.

And these become kind of that treasure hunt phenomenon that we're seeing right now, where customers come in, they can look for something that really match their budget. They have the confidence of knowing it's been refurbed by Geek Squad agent, and they can get that great product. Also often, maybe a warranty or a membership attached to it so they have that confidence in the product over time.

So outlets is a known strategy, carefully expanding that where we think it makes sense in that market approach to make sure we feel like we're meeting the needs of the market. Then we gave two other examples. We gave the Bosman example, which we were implicit in saying that is smaller market where we otherwise maybe would not have entered, but we found a smaller format store with an operating model that we think will work in some of those markets.

Now unfortunately, Joe, we just opened that store last week. So we're a little light on insights at this point. What I can tell you, it was fun to see a community that was really excited to have us there, and literally went out of their ways, and I'm so proud of the store teams there to say they were so excited to see Best Buy entering the market.

The other example we gave which is Kansas City. Likewise, we just opened that not even a week ago. So unfortunately, I also don't have a lot of insights yet from that. But you can imagine, we're going to be keeping a close eye on what we can see in those stores and what the different thesis looks like because in the Kansas City example, that was closed a big store and then open a smaller one.

So you still have that point of presence, but you maybe don't even have all the bells and whistles that you had at a larger store. And I think we'll continue to compare those against we already had, as you well know, 20,000 square foot stores that are a bit smaller format can serve maybe a little bit more isolated population.

And we also continue to watch those, which for us has been a profitable model. So I think we're working on how in a market-based, where do you put these different models together. So you can serve the market with plenty of points of presence, but in a way that reflects both the digital shift for shoppers and a market that might just look a little bit different than a large city.

Joe Feldman - *Telsey Advisory Group - Analyst*

Got it. That's really helpful. Thanks, Corie. And maybe just a quick follow-up. You talked about the marketplace. And I guess I was wondering if -- I know it's a next year event, but I'm wondering where you guys see the opportunity for Best Buy to have a marketplace like maybe some of the advantages that you guys see that Best Buy can offer to the providers, 3P providers?

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

It's been really interesting to watch our Canada counterparts operate a marketplace, which they have for a number of years and to learn a bit from them about how maybe you can augment your more traditional assortment and ways of going to market with a bit of a deeper offering for your customers.

So I'll start with that. The second thing is customer shopping behavior is very different. And we've talked about this a lot, but you have to underscore how much more shopping is done digitally and how much deeper into the catalog you can go digitally if you have the right partners in more of a marketplace kind of model.

And we can actually see, you can imagine, when our customers are searching for things that we might not currently offer. And so, I wouldn't think about this as all of a sudden, you're going to come to Best Buy and like there's this magical huge marketplace that has everything.

This will be a curated, tailored marketplace to the customer that is coming to shop with us and those deeper assortments that you would hope you could provide. You can imagine, in store, I can't provide every colorful cell phone case on the planet that tailors to everyone's unique desires. Trust me, as the mom to teenagers, there are many unique cell phone case desires.

But if you have this newer marketplace approach, you can go very deep into that part of the assortment, still offer that great assortment, but it's also very aligned with who we are as a consumer electronics retailer. And then the last thing I would say, Joe, is we're also thinking really carefully about the experience.

And so, sometimes the other flip side of the question that I might get is like, why is it taking you a little while to get there? Because we want the in-store experience to work with the digital experience. We want the search experience really importance to able to work.

We want all the fulfillment experiences to be able to work. The membership experiences, any associated Geek Squad experiences. And so, we're really working hard to make sure we uniquely to Best Buy bring to life a marketplace that we hope serves some of our consumers' broader needs.

Operator

Karen Short, Melius Research.

Karen Short - *Melius Research - Analyst*

Hey, thanks very much and good to talk to you again. A couple of clarifications. When you look at your implied 4Q guidance, there is a very wide range on operating income. So wondering if you could talk about that a little bit. And then I know you've been reluctant to provide this, but any color that you would be willing to provide on membership renewal?

Matthew Bilunas - *Best Buy Co Inc - Chief Financial Officer*

Sure. I'll start, maybe Corie can jump in. I think in terms of the OI dollar range in Q4, it is wider. We're guiding anywhere from 4.6% to 4.8% rate. I think the biggest thing to call out there, there probably isn't a lot of difference on the gross profit side. The gross profit is probably a pretty similar level of increase on that range.

I think as you get it from a flat comp down to a minus 3% comp, you obviously reduce variable expenses. As the sales decrease to a certain extent, but obviously, there's a fair amount of the sales rate to leverage -- SG&A deleverage as you move to the bottom of that on the sales guidance range. So I think that is for the most part the biggest difference between dollar amounts on the guide for Q4.

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

(multiple speakers) And Karen, we've been -- love the question on membership. We've been really consistent on making sure we always tack back to the goal of our membership program, which is to drive engagement and increase that share of wallet.

And you're right, we're looking at three things any time we're talking about that. That is acquisition, engagement and retention. And what we like, we continue to grow new customers into the program in Q3. Our paid members consistently are showing higher levels of interaction, comparatively higher levels of spend.

And while it's early because we still are just lapping all the changes that we made. At this point, retention rates are outperforming our expectations that we had internally for both total and for plus. So we're happy with that. You're right, we're not giving any precise retention rates, but at least they are outperforming our expectations.

Operator

Seth Basham, Wedbush Securities.

Seth Basham Basham - *Wedbush Securities Inc. - Analyst*

Thanks a lot, and good morning. If we could just double-click on the laptops category, and if you wouldn't mind telling us how that performed in terms of year-over-year growth in the second quarter relative to 7% in the third quarter.

And then some color around what customers are gravitating to in laptops, how much is replacement driven, what features they're going after, whether it be battery life or AI and how you expect that category trend going forward? Thank you.

Jason Bonfig - *Best Buy Co Inc - Senior Executive Vice President of Customer Offerings and Fulfillment*

Thanks for the question, Seth. Let's start with laptops and tablets combined. The comp for those was 5.2%, which was down slightly in Q2. The biggest change there was that the new iPad launched in Q2, which is what drove that slightly.

Laptops in itself though had a 7% comp, which is the highest comp we've seen since April of 2021. We do think right now that we're excited about AI, and obviously it's getting to be a larger percentage of our assortment. In fact, on the premium side of Windows, it's about 50% of the total assortment right now. We're up to 60 total SKUs. AMD and Intel are now there in addition to Qualcomm. And of those SKUs, we actually have about 50% of those SKUs are exclusive to us.

But we think a lot of the interest right now is really on upgrade and replacement cycle, and that AI will continue to drive interest moving forward, but it's really customers back into the market and replacing technology. That's why we're seeing strong sales across the entire portion of the assortment, including even things like gaming.

So we're excited to what's going to happen in the future with AI. We think it's a phased approach. There'll be new features in AI across all the different platforms. And it's not just Microsoft, it's obviously Apple and Google are there as well. But right now, we do think the biggest thing that's driving is really that upgrade and replacement. And that will probably continue into next year as we think about the end-of-life support of Windows 10 that happens in October 2025.

Operator

Seth Sigman, Barclays.

Seth Sigman - *Barclays - Analyst*

Hey, guys. Good morning, everyone. A couple of things that I want to follow-up on. I guess, just first on the quarter-to-date 5%, obviously, a lot stronger. I may have missed this earlier, but can you just help us understand maybe what the underlying trend is when you consider the shift?

I wonder if the best way to look at it is maybe in the [last three week], I mean, do you think there's pent-up demand that maybe got shifted out of the early fall period into November? Just any more context on that would be really helpful.

Matthew Bilunas - *Best Buy Co Inc - Chief Financial Officer*

Yeah. First, in terms of the week shift, the week shift really doesn't have an impact on the 5% comp so far for the first three weeks. If you think about this November versus last November Thanksgiving, it's in the same week four in both post period. So there really isn't an impact to the week shift from that regard.

The 5% in terms of the strength there, I think, you're right. We did see the business trend down in September and October. Again, we're seeing those values between sales events a little deeper all year long. We've been seeing that. So there likely is some level of people who are waiting until the holiday season, and that's coming through in this 5% number.

Although, I would say we are doing a great job merchandising, bringing back the Doorbusters, which is also generating, stimulating demand, but I think you're right. And there is a little bit of a -- the values that are a little deeper and then the sales events get a little higher, which is why we're also thoughtful about our Q4 guidance total being at a 5% three weeks and it's still at the high end flat comp.

We would expect based on the timing and the promotion changes this Q4, see some level of potential slowdown as we get past the holiday period into December.

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

And I think we're also just trying to be thoughtful about the reallocation of less shopping days. Those are going to come in lots of different ways, which is going to make restating weeks, just incredibly painful for everyone.

But some of that is going to get probably pulled up a little bit earlier. Some of it will get squished in the middle a little bit deeper. So I think we're -- like everyone trying to make sure that we're thoughtful about how all those extra days get reallocated back into the rest of the shopping season.

Seth Sigman - *Barclays - Analyst*

Okay. Super helpful. Thank you for that. And then the follow-up is just around promotional activity. Could you talk a little bit more about what Best Buy is doing relative to the industry? I thought there was an implication that you're not being as aggressive, more targeted, and you've done a good job of that historically. But just curious how you frame that and what you're seeing maybe more broadly from a competitive perspective.

Corie Barry - *Best Buy Co Inc - Chief Executive Officer, Director*

Yeah. I would not frame it as less aggressive. I want to be explicit about that. And in fact, we went into the year saying we're going to make price investments this year so we could maintain our share position in some of those really key categories for us, like computing and TVs and appliances.

I think what Matt hit on earlier is something that's important, which is elasticity has been inconsistent. And our teams are very, very good about trying to understand as they put promotions out in place, what is it the consumer responding to versus where are we putting in promotions and the consumer is not responding.

And I think what they've done is a very nice job of tweaking the promotional plan throughout the year as we see responses. We are definitely in drive time seeing some responses, and that's amazing.

On those valleys, to your point though in between, it can be very hard to stimulate demand because the customer, just almost like regardless of price point just as not as interested in the product. So I give the team a lot of credit for consistently trying to figure out how to optimize those drive times. And at the same time, make good decisions when the consumer doesn't seem as likely to want to make purchases.

Mollie O'Brien *- Best Buy Co Inc - Head of Investor Relations*

Before we end the Q&A, we'd like to visit a question that came at the beginning of the Q&A, it appears there was some technical difficulties. So Corie, if you could go back to on the earlier question about products coming from China and Mexico and our approach thought on tariffs.

Corie Barry *- Best Buy Co Inc - Chief Executive Officer, Director*

Yeah. So maybe I'll restate the thoughts on tariffs, and you can all see if I do it the same. So first of all, I want to make it clear, it's very important for us that we try to work with the administration. We have historically when it comes to the issue of tariffs, and we definitely want to be as supportive as possible.

But a few key facts here as it relates to us. One, ours is an incredibly complex industry with a very complex supply chain. And I think at the end of the day, everybody in the industry agrees that diversification is a very good thing, but it's also not easy because these are such technical supply chain.

Two, we directly control very few of these supply chains. We're the importer of record on only about 2% to 3% of our product. And in those products that we control, the vast majority of that and those products that production has been moved out of China.

So as we said before, just to give an update, last time we gave an update, about 60% of our cost of goods sold came from China. And again, this is working with our vendor partners based on best we can discern. That number is probably about consistent right now with what we were seeing before.

Before, I think we had hoped that some of that would move or a more material portion would move, but COVID and the associated supply chain disruptions that happened, ramping production way up and then way back, I think disrupted some of that movement of those supply chains.

And then our second largest country of import is Mexico. So that kind of gives you an idea of where we're bringing in and very there's very little in the consumer electronics space that is not imported. Almost everything is imported in CE.

I would also see tariffs that are very complex, which you all know, it depends on the rules that are used, whether or not there are investigations, congressional involvement, which countries, what level, is it a phased approach, are there exceptions, is there an openness to feedback. And so, obviously, I think it's going to be a very fluid situation as we continue to work through it.

Typically, in history, this ends up being some kind of costs that are shared. Some extent, the vendors have some. Ro some extent, Best Buy. Of course, we see that the customer ends up bearing some of the cost of tariffs, and we've seen this before.

And for us, that's the hardest part. These are goods that people need and higher prices are not helpful. I think you've seen many external organizations intimate CTA and NRFs that these are high-priced items that are going to be higher priced if there are tariffs involved. And so, again, we will continue to try to work on that.

The other part of the question I didn't answer before that Peter had asked is are there plans to mitigate and what are some of the mitigation strategies. And you can imagine that's everything from if you know there's going to be products, bringing some in ahead of the tariff implementation.

There are decisions around vendor and SKU assortments, there are promotional and pricing strategies. There are sourcing changes, which I think our vendor partners are also working hard on. And there are other strategies that we employ in partnership with our vendor. I think this is where our close vendor relationships really tend to pay off for us.

So it's obviously an evolving issue. It's when this team has a great deal of experience navigating, and we are already planning for and working with our vendor partners on next steps.

And with that, I want to thank you all for joining us for the call today. I know it's busy out there. I hope everyone listening has an absolutely wonderful holiday, and we look forward to updating you on our results and our progress during our call next March.

Operator

That concludes today's Best Buy third quarter fiscal 2025 earnings call. Thank you all for joining. I hope everyone has a great day.
