Lowe's Companies (LOW) Earnings Report: Q1 2016 Conference Call Transcript

The following Lowe's Companies conference call took place on May 18, 2016, 09:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Robert Niblock; Lowe's Companies Inc.; Chairman, President & CEO
- Rich Damron; Lowe's Companies Inc.; COO
- Bob Hull; Lowe's Companies Inc.; CFO

Other Participants

- Simeon Gutman; Morgan Stanley; Analyst
- Greg Melich; Evercore ISI; Analyst
- Chris Horvers; JP Morgan; Analyst
- Michael Lasser; UBS; Analyst
- Matthew Fassler; Goldman Sachs; Analyst
- Seth Sigman; Credit Suisse; Analyst
- Mike Baker; Deutsche Bank; Analyst
- Eric Bosshard; Cleveland Research Company; Analyst
- Seth Bashum; Wedbush Securities; Analyst
- Kate McShane; Citi Research; Analyst
- Peter Benedict; Robert Baird; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Good morning everyone and welcome to Lowe's Companies' first quarter 2016 Earnings conference call. This call is being recorded.

(Operator Instructions)

Also, supplemental reference slides are available on Lowe's Investor Relations website within the investor packet. While management will not be speaking directly to the slides, these slides are to facilitate your review of the Company's results and to be used as a reference document following the call. During this call, management will be using certain non-GAAP financial measures. The supplemental reference slides include information about these measures and reconciliation to the most directly comparable GAAP financial measures.

Statements made during this call will include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Management's expectation and opinions reflected in those statements are subject to risks, and the Company can give no assurance that they will prove to be correct. Those risks are described in the Company's earnings release and in its filings with the Securities and Exchange Commission.

Hosting today's conference will be Mr. Robert Niblock, Chairman, President, and Chief Executive Officer; Mr. Rich Damron, Chief Operating Officer; and Mr. Bob Hull, Chief Financial Officer. I will now turn the program over to Mr. Niblock for opening remarks. Please go ahead, sir.

Robert Niblock (Chairman, President & CEO):

Good morning and thanks for your interest in Lowe's. Comparable sales grew 7.3% in the first quarter, exceeding our expectations driven by comp transaction growth of 5.1% and a 2.2% increase in average ticket.

I'd like to thank our employees for their continued efforts in serving customers, which enabled our strong transaction growth. The teams [private] expertise and commitment to customer service allowed us to capitalize on the strong home improvement demand in the quarter. Healthy macro fundamentals, favorable weather and a compelling offer drove demand resulting in strength in indoor as well as outdoor projects.

In fact, we reported positive comps in all 13 product categories, with particular strengths in lumber and building materials, millwork, paint, lawn and garden, and tools and hardware, which all posted comps above the company average. Our emphasis on providing better Omni-channel experiences position us well, enabling us to connect with customers and provide the advice and assistance they count on when completing their home improvement projects, whether they choose to connect in the store, online, in their home or through our contact centers.

We're also pleased with the investments we've made to build deeper relationships with the Pro, as our Pro business performed well above the Company's average. The work we've done to enhance our product and service offering is allowing us to better serve this important customer segment and we will continue to deepen those relationships.

From a geographic perspective, our US home improvement business achieved 7.5% comps for the quarter, with all 14 regions delivering positive comps. We continued our strong performance in international markets including double-digit comps in Canada in local currency.

For the quarter, we generated 170 basis points of operating margin expansion. Included in the quarter results is a $160 million unrealized gain on a foreign currency hedge entered into in advance of our pending RONA acquisition. Including this benefit, we delivered earnings-per-share of $.98, a 40% increase over last year's first quarter, delivering on our commitment to return excess cash to shareholders.

In the quarter, we re-purchased $1.2 billion of stock under our share repurchase program and paid $255 million in dividends. I'm also pleased with the progress of our previously announced acquisition of RONA. The transaction was approved by RONA's common shareholders in March and last week, we received authorization from the Canadian regulatory agencies clearing the way for closing of the transaction this Friday.

The time is right to fortify our Canadian market presence to take advantage of the significant long-term potential we see. We expect to build on the recent progress our team in Canada has made and the positives result RONA has achieved over recent years as a result of their restructuring efforts.

Turning to the economic landscape for the balance of the year, the outlook for the home improvement industry remains positive. Persistent gains in the job market, as well as disposable income growth is expected to out pace growth and the economy should contribute to solid growth in consumer spending. Housing remains a bright spot, with home sales and construction activity, posting healthy games to start the year, while home prices continued their steady upward trend.

As a result, the home improvement industry should continue to benefit from a solid consumer housing backdrop, even as the held back from even as the benefit of favorable weather at the start of the year normalizes. And, as we survey the consumer we're seeing similar things. Our most recent consumer sentiment survey revealed that favorable views around personal finances and home improvement spending are holding steady. Raising home prices are motivating homeowners to invest in the homes and many believe that this trend will continue, as the survey revealed a significant increase in future home value expectations.

Likewise, we continuously see home improvement spending outpaced overall spending, as well as positive home improvement project -- project intentions. We will continue to focus on improving our product and service offering for the Pro customer and differentiate ourselves through better Omni-channel customer experiences that make us the project authority in order to leverage the favorable home improvement backdrop.

Our strategic framework, along with efforts to improve our productivity and profitability gives us confidence in our business outlook for 2016. Thanks again for your interest and with that, let me turn the call over to Rick.

Rich Damron (COO):

Thanks Robert and good morning everyone. We executed well in the first quarter, growing both average ticket and transactions. In addition to our successful spring Black Friday events, we drove traffic through compelling offers designed to take advantage of early spring project demand, leveraging enhanced digital capabilities and improved marketing speed and flexibility to reach the spring customer earlier in the season.

And as Robert shared with you, we delivered positive comps across all regions and product categories, as we continued to capitalize on a favorable macro backdrop and consumers increasing desire to invest in their home. These favorable trends in home-improvement, coupled with our compelling product offering in strength in Omni-channel retailing contribute to a particularly strong performance in categories such as; lumber and building materials, millwork, paint, lawn and garden, and tools and hardware.

We achieved double-digit comps in lumber mill materials, driven by a continued search in outdoor construction projects, coupled with stronger demand from the Pro customer. Millwork also benefited from this dynamic, as outdoor projects grow strong performance in windows and doors.

As customers look to improve and enjoy their outdoor living space, the outdoor living experience we introduced in 2014 continued to pay dividends, delivering single-digit comps in patio and outdoor fashions for yet another year. We also continue to see robust attachment of accessories, as the showroom feeling created [sow] helped customers envision and create their outdoor space. Our targeted offers and events designed to capitalize on early spring drove demand -- drove demand high single-digit comps in lawn and garden category, with particular strength in garden-lines, live goods, soil and mulch.

Our new landscape lighting experience was also a success, helping customers visualize their outdoor living, lighting projects and making the selection and installation easy, while offering innovative technologies like LED. This -- this project strength extended to inside the home as well, as we also saw strong performance in interior project categories.

Within fashions fixtures, we leveraged our customer experience design capabilities to optimize our recent lighting recess, showcasing and expanded collection of inviting styles, finishes and brands available both in-store and online, including the introduction of Kichler and [Kozel] lighting, both home channel exclusives. Along with [Progress] lighting, we now offer the top three lighting brands in the industry, providing our customers with an exceptional array of options and styles.

We combined our extended product offering with a simplified presentation, designs with the needs of the customer in mind, grouping lighting fixtures by style and collection to provide a cohesive decorating solution and simplify selection. Customers have responded well, driving double-digit comps in interior decor lighting and chandeliers. We're now extending this approach to ceiling fans, to leverage our relationship with Hunter [fans], as well as our private label brand and sourcing capabilities.

We saw mid single-digit comps in appliances, flooring and kitchens, further demonstrating the consumer's continued willingness to engage in interior projects. Paint performed above the Company average, driven by strength in both interior and exterior projects. Our paint line-up which showcases Valspar, Sherman Williams and PPG Olympic provides customers with a full suite of top brands they trust for the paint projects. Tools and hardware also benefited from the increased project activity, from both DIY and Pro customers.

We were able to capitalize on this demand by improving our tool brand assortment, with exclusives like Hitachi and Bostitch, the number one and number two brands in [numatics] and the extension of brands like Vaughan, along with our extensive private-label line of cobalt tools. Whether working on indoor our outdoor projects, our Omni-channel capabilities help customers achieve great results.

Customers can engage with our associates in-store for expert advice, our content on Lowes.com for inspiration, our contact support for on-going support, or our project specialists who work with them in their homes. On Lowes.com, we have upgraded our online shopping experience with enhanced product content insert functionality, improved visual tools such as 360 degree product views, improved video content and the continued expansion of click-to-chat capabilities to better support the customers digital experience.

As a result, we continue to see positive customer response and very strong growth in our on-line channel. Our exterior and interior project specialists to meet with customers in their homes to design, plan and complete their home improvement projects represent another critical element of our Omni-channel strategy.

Our exterior product specialists are available across all US home improvement stores and we are expanding our interior project specialist program, reaching all US stores by the end of this year. Our in-home sales program continues to outperform with above average comp growth again this quarter. Our expertise in product inspiration, project design and project execution are setting us apart as the project authority in home-improvement at a time when the consumer continues to demonstrate a willingness to take on home improvement projects.

We continue to strengthen our Pro business, driving comps well above the company average by further advancing our product and service offering to better serve the Pro customer. Beyond improvement in our tools offering, we've also strengthened our portfolio of Pro focus brands with the addition of; GAF roofing, Owens Corning insulation, Lennox HVAC and Masonite entry and interior doors.

We continue to collect feedback from Pro customers, our outside sales team and store employees, while working closely with our field-based merchandising managers to identify local market opportunities and brands to further optimize our offering to the Pro. We have also advanced our Omni-channel resources for the Pro. We continue to utilize feedback from our Pro customers and Pro services team to enhance the features and functionality of our Lowesforpros.com site that we re-launched last year, making it easy for Pros to manage multiple prop -- property and quickly purchase items nationwide.

Thus far, we have been pleased with the program rollout given the positive customer response and early results which have exceeded our expectations. Another critical element of our Omni-channel for the Pro customer is our account executive Pro services, or AEP's. AEP's work with larger regional customers to have them order and replenish products across multiple geographies and locations. Our AEP's are a key component of our strategy to grow our business with larger Pro customers.

We currently have over 180 Pro outside representatives in the field and have experienced great success with the program, with continued strong growth in AEP comp sales. Building on this success, we will continue to grow the program, adding additional AEP's to continue capturing market opportunity with large Pro customers. We are also reaching out to the Pro through targeted marketing and special events, such as credit events, bonus days and spring Pro appreciation days to drive awareness and generate new business.

We've been pleased with these results in driving both incremental purchases with existing Pro customers and building relationships with new customers. Our work to strengthen our portfolio brands, as well as expand our Omni-channel offering through our growth -- growing Pro services team and our re-launch of Lowesforpros.com are part of our broader commitment to build on a strong foundation with the Pro.

This foundation includes dedicated service in our stores, inventory depth aligned with the needs of the Pro, job site delivery and our value proposition, including a 5% off everyday loyalty program for Pros using Lowe's proprietary credit, as well as reduced delivery rates. In addition to our efforts to drop top-line growth, we continue to focus on driving productivity and profitability.

For the quarter, gross margin contracted as strong in lower margin categories such as lumber and building materials led to a negative, mixed impact. So while we planned targeted promotions to capitalize on strong spring demand, the participation rate in those offers exceeded our expectations, which together with markdowns associated with reset activity led to a negative rate impact. Our stores once again effectively managed payroll hours on very strong comp sales growth, driving payroll expense leverage. They drove this leverage while achieving continued strong customer satisfaction scores. As you can see, we had a strong first quarter.

We continue to make progress on our initiatives to drive top-line growth and are focused on improving productivity and profitability. We look forward to sharing further progress with you over the course of the year. Thank you for your interest in Lowe's and I will now turn the call over to Bob.

Bob Hull (CFO):

Thanks Rick and good morning everyone. Sales for the first quarter were $15.2 billion, an increase of 7.8%. Total transaction count increased 5.5%, and average ticket increased 2.2% to $68.08. Comp sales increased 7.3% driven by the comp trends transaction decreased from a 5.1% in average growth of 2.2%. Looking at monthly trends, comps were 8.3% in February, 9.1% in March, to 4.9% in April. Comps were stronger earlier in the quarter, as we capitalized on favorable weather to drive above plan comps. April sales were consistent with our plan coming into the quarter.

Gross margin for the first quarter was 35.04% of sales, a decrease of 43 basis points from last year. The decreasing gross margin as a percent of sales was due to rate pressure as well as the mix of products sold. The rate pressure related to targeted promotions and markdowns associated with reset activity.

SG&A was 22.3% of sales, which leveraged 180 basis points. In anticipation of the RONA acquisition, we entered into a four currency hedge to lock in the purchase price in US dollars. In the quarter, we recorded a $160 million unrealized gain, driving 105 basis points of expense leverage. Also, store payroll leveraged 13 basis points as we continued to optimize our staffing model. Utilities leveraged 11 basis points as result of warmer weather relative to last year.

Lastly, there were numerous other expenses that leveraged between 5 and 10 basis points in Q1. Depreciation for the quarter was $357 million, which was 2.34% of sales and leveraged 25 basis points compared to last year's first-quarter, as a result of higher sales and assets becoming fully depreciated. Earnings before interest and taxes increased 170 basis points, 10.42% of sales. The unrealized gain on the FX hedge accounts for 105 basis points of the increase versus last year.

Interest expense at $156 million for the quarter delivered 8 basis points to last year, as total debt increased for $4.1 billion versus the first quarter of 2015. We issued $3.3 billion of unsecured bonds in April. The transaction consisted of 3, 10 and 30-year issuances with a weighted average interest rate of 2.72%. The proceeds will fund the RONA acquisition, as well as refines current year maturities. Effective tax rate for the quarter was 38.2%.

Earnings per share of $.98 for the quarter represent a 40% increase over last year's $.70. The $.98 includes $.11 related to the FX hedge gain. We exceeded our earnings plan for the quarter even without the gain.

Now, to a few items on the balance sheet starting with assets. Cash and cash equivalents at the end of the quarter were $4.6 billion. The higher cash balance is a result of the April [fund] deal. Our inventory -- Our first quarter inventory balance of $11.1 billion increased $441 million or 4.2% through the same period last year. Inventory turnovers 3.83 times, an increase of 5 basis points over Q1 2015.

Moving onto the liability section of the balance sheet, accounts payable is $8.8 billion increased $798 million or 10% over Q1 last year. The increase in Accounts Payable is due to the timing of purchases in the quarter versus last year and a three day improvement in days payable outstanding.

At the end of the first quarter, [lease]-adjusted debt to EBITDAR was 2.45 times. The higher the target leverage was the result of the April bond deal. We expect it back in line with our 2.25 times target within one year of the RONA transaction closing.

Return on invested capital decreased 64 basis points for the quarter to 14.98%. The net impact of the non-cash impairment charge recognized in the fourth quarter related to the exit of our joint venture in Australia and FX hedge gain this quarter reduced ROIC's by $145 basis points.

Now looking at the statement of cash flows. [Op and] cash flows was $3.2 billion. [Calc] expenditures were $208 million, resulting in free cash flow of $3 billion. Free cash flow was $766 million or 34.1% over the same period last year. In February, we entered into a $500 million sell-rated share repurchase agreement. We expect to receive approximately 6.8 billion shares, but the ultimate number of shares will be determined upon the completion of the program in the second quarter.

We also repurchased approximately 9.7 million shares for $700 million through the open market. In total, we repurchased $1.2 billion in the quarter. We have approximately $2.4 billion remaining on our share re-purchase authorization. The remaining $53 million of share re-purchase is shown on the statement of cash flows relates to the shares withheld from employees to satisfy statutory tax withholding liabilities.

Looking ahead, we'd like to address several of the items detailed in Lowe's business outlook. First as a reminder, fiscal year 2016 will include an extra week in the fourth quarter, for a total of 14 weeks and 53 weeks for the year. We estimate that the 53rd week with aid total sales by approximately 1.5%, and earnings per share by $.05-$.06. Second, while we have received shareholder approval and authorization from regulatory agencies, we have not closed on the RONA acquisition.

As a result, our outlook excludes the impact of this transaction. Finally, while we did outperform our Q1 sales of earnings plan, we continue to think about spring within the context of the first half of the year. We are confident in our plans and hope to sustain momentum, but we are in the middle of the spring season and believe it's prudent to maintain our previously provided outlook.

Now, let's get into that outlook. As Robert noted, the forecast for home improvement industry remains positive. For 2016, we expect total sales increase of approximately 6%, driven by a comp sales increase of 4%, the impact of the 53rd week and the opening of approximately 45 stores, which includes 20 orchard locations and 12 stores in Canada.

For ease of modeling, the EBIT growth rate excludes the impact of last years Australian joint venture [repairment] charge and this year's FX hedge gain. We are anticipating an EBIT increase of 80 and 90 basis points. The effective tax rate is expected to be 38.1%. For the year on a GAAP basis, we expect earnings per share of approximately $4.11, with the incremental $.11 from our prior guide coming from the FX hedge gain. We are forecasting cash flows from operations to be approximately $5.4 million.

Our capital plan for 2016 is approximately $1.5 billion. This results in an estimated free cash flow of $3.9 billion for 2016. Our guidance assumes approximately $3.5 billion in share re-purchases for 2016. The share repurchase assumption is not expected to be effected by the RONA acquisition.

[Operator], we are now ready for questions.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

[Scott Kitchrelly] with RBC Capital Markets, please go ahead.

Unidentified Participant:

I hate to kind of lead with a short-term factor like weather, but Bob is there any estimate you guys have in terms of what -- what kind of impact the weather had on the comp in the quarter in total, and by any chance would you have what's called a monthly cadence, on a weather-adjusted basis month-by-month?

Bob Hull (CFO):

Scott, so we estimate that weather impacted Q1 performance by roughly 150 basis points. As I mentioned in my comments, that impact was more pronounced in the first part of the quarter. I don't have the 150 basis points dissected by month at this time.

Unidentified Participant:

Okay and then just -- I appreciate that. Just on the margin, you mentioned a couple of different things impacting it, from the promotions, the mix. Can you give us any color regarding the relative size of the impact of each of those factors?

Bob Hull (CFO):

Scott, the three factors that we mentioned, the mix of products sold, the reset activity, target promotions -- each had roughly 15 basis points impact.

Unidentified Participant:

So roughly even. All right, thanks guys. I'll pass the torch.

Operator:

Simeon Gutman with Morgan Stanley. Please go ahead.

Simeon Gutman (Analyst - Morgan Stanley):

Thanks, so first I guess a follow-up to Scott's first question, regarding the 150 basis points Bobby answered on the seasonal impact. Can you talk about how much -- or the weather impact -- how much that could've been from projects that -- that was -- that got started earlier versus outdoor seasonal products that sold through?

Bob Hull (CFO):

As I mentioned in my comment Simeon, we think about spring as a first-half event. We don't spend a lot of time trying to dissect what might've sloshed between quarters. So certainly the mild winter weather enabled exterior projects. We saw all that show up in some of the categories that Rick mentioned that outperformed. But the ultimate impact we'll determine at the completion of the second quarter when you review our spring results.

Simeon Gutman (Analyst - Morgan Stanley):

Got it, okay. Then -- and then thinking through gross margin, are you able to share with us the difference in product margin and some of those categories, seasonal, lumber and building materials and should we see the gross margin bounce back to that -- to some extent in the second quarter, reflecting the product mix?

Unidentified Company Representative: So what I would say is that the lion share of the mixed impact related to lumber and building materials -- so, if the demand for those categories remains strong, we could have additional mixed pressure in the second -- or in the remainder of the year. However, we would also generate additional sales from that demand. In addition, the other two items, the targeted promotions and the reset activity are largely Q1 events and we don't expect a lot of residual impact beyond Q1 for those items.

Simeon Gutman (Analyst - Morgan Stanley):

Okay great, thank you.

Operator:

Greg Melich with Evercore ISI, please go ahead.

Greg Melich (Analyst - Evercore ISI):

Two questions, one is (inaudible) about guidance and the fact that it was a good, strong start to the year, and if we keep that 4% comp guidance, on my math it implies that the rest of the year we're going to be running like 3% of 3.5%. Is that what you're seeing now, especially given if I remember correctly, May is actually easier comp then April was a year ago. And then I had a follow-up.

Robert Niblock (Chairman, President & CEO):

Greg, this is Robert. I'll start and then I'll turn it over to Bob. I think just as we've done in the past few years, generally coming out in the first quarter, we've not changed our guidance for the year, so we're following a cadence very similar to what we've done in the past. We think it's too early, high in the year to be changing our guidance. I think this is very consistent with what you've seen the past few years, whether we've started off with a robust first quarter or a first quarter that was, let's say whether challenges we had a couple of years ago. So Bob, if you'd like to...

Bob Hull (CFO):

Yes, so Greg look a couple of things I'll [read] here like [April first]. We felt good about April, April was plan. Second, we hope to sustain a momentum that we're seeing. So, we're excited about our plans and remain confident in our ability to execute. There's nothing of suggestive that we're not able to execute the guidance we've put forward.

Greg Melich (Analyst - Evercore ISI):

So, if April was on plan, then presumably May is on plan.

Bob Hull (CFO):

As we talk about the guide annually, we feel good about the opportunity to deliver our results, we're not going to get into the short-term nuances of this quarter versus that quarter, but we are confident in our ability to execute.

Greg Melich (Analyst - Evercore ISI):

OK, great. And I guess the follow-up was about for the margin progression in the first quarter and more on the gross margin side. You talked about targeted promotions un-related to reset. Are there other categories that you're going to be resetting and doing this with that we should expect in the second and third quarter or for just the rest of the year, or was that something more specific to the first quarter and how it plays out?

Bob Hull (CFO):

Greg, it's more specific to the first quarter and normalizes throughout the balance of the year.

Greg Melich (Analyst - Evercore ISI):

Got it, thanks. I'll let someone else have a chance.

Bob Hull (CFO):

Thanks Greg.

Operator:

Chris Horvers with JP Morgan, please go ahead.

Chris Horvers (Analyst - JP Morgan):

Thanks, good morning. So following up on the margin, so was gross margin in-line with your plans? And then the other side of it is the SG&A came in much better, even if you back out the foreign currency hedge gain. So, that was very strong so was that also in your plan? As you think about putting up a 7% comp in the first quarter which is fantastic, the flow-through I guess wasn't very large and I know that you talked about that -- that one key was going to be light. But you were also I think embedding more of like a 5% comp. So I guess that -- those extra two points then drive us much closer as one would've thought.

Bob Hull (CFO):

The gross margin came in a little below our plan for a couple of reasons. First, as Rick talked about, we had greater take-rate in the targeted promotions. So, we had an estimate of impact, the customers activity was stronger then we anticipated which was certainly a good thing and kudos to the team for identifying the items that resonate with customers. Second, we expected impact from the reset to be a little bit more balanced Q1 and Q2. We had good sell-through run on the recent activity, therefore that impact was more pronounced in the first quarter.

As I mentioned, that kind of clears the debt in Q2 going forward. And lastly, the mixed structure was a little bit higher then we anticipated based on the strong demand of lumber building materials. As it relates to the flow-through, so the lower than anticipated flow-through was almost entirely attributable to the decline in gross margin versus plan, again based on the factors I just described.

Chris Horvers (Analyst - JP Morgan):

Understood. So the SG&A came in where you thought it would be and there was no up-and-down because of you know -- what you talked about on the fourth quarter, a switch between financing offers versus promotional offers?

Bob Hull (CFO):

No, there was a subtle nuance within credit, as it relates to our partner and they made a change that impacted us last year regarding the loan-loss reserve. The trailing impact of that hit Q1 that was modest pressure in Q1. That's largely done, so that's a pressure in Q1 that we won't see Q2 going forward, but not otherwise -- there's nothing out of the norm.

Chris Horvers (Analyst - JP Morgan):

Understood, thank you. And then as a follow-up, there are a lot of companies who are talking negatively about the consumer target. For example, this morning, following other companies, department stores last week, Costco being a little bit light. So is there anything as you peel back the demand, whether it's regionally, in California, is - ticket versus traffic, deceleration in the quarters, is there anything that you're seeing that would suggest a deteriorating consumer backdrop?

Robert Niblock: Chris, this is Robert. As I outlined in my comments, as we've seen the consumers, we look through our consumer sentiment survey, with the intentions are around investing in the home, as we're seeing continual improvement in the job market, we're seeing continual improvement in wages, we're seeing continued improvement in home values -- it's driving continued improvement in their intentions for discretionary spending, which I think the best evidence of that is in the 5.1% increase that we saw in comp transactions during the quarter.

Nothing that we've seen in our [summit] surveys have led us to believe that the consumer -- when they -- we ask them, how do you feel six months out with regard to your purchases? Nothing shows any change in their intentions as we survey them today. So that I think is why, as Bob took you through it, strong first-quarter. We're aware of what others are saying out there with regard to the consumer, but when we take this the --our strong first quarter performance and what we're hearing from the consumer on the service -- survey and gives us confidence in reiterating our guidance through the year that Bob has taken me through.

Chris Horvers (Analyst - JP Morgan):

Thanks guys.

Operator:

Michael Lasser with UBS, please go ahead.

Michael Lasser (Analyst - UBS):

Thanks for taking my question. So this is the second quarter in a row where you were a little bit more promotional. It seemed to have maybe a greater impact this quarter. Can you talk about the influence that some of the increased promotional activity that you engaged had on the comp? What are you learning about consumer price elasticity across various categories -- I know this is a three-part question, I apologize. Is the promotional activity more pronounced in-store or on-line? Thank you.

Unidentified Company Representative:

(Inaudible) I can take that. First let me -- I'll just talk about where we focused our promotions and a little bit about the -- how we went about it first quarter. We're more focused lawn and garden seasonal living, tools and hardware, major appliances and interior projects because we thought those would be the types of products and projects consumers minds have -- were being geared towards.

We leverage our sales and operation process, and what's important about this process is it allows us to have a better sense on the micro seasons that applied to the consumers mindsets, so that we hit the consumer with the right promotion, at the right time. We're much faster and being able to flex our promotions and our digital assets because of some of the investments that we made in our digital capabilities.

And what we saw was, was our higher take-rate and as Bob said earlier, that's certainly a good thing. A flexible supply chain allows us to make adjustments to -- where the consumers making purchases and ensure that we don't disappoint them by not having product. But I wouldn't say that the intensity and depth of promotion was -- was great.

What I would say is that our execution around promotions continues to get better. So we -- we're doing a much better job of getting the right promotions in front of the customer at the right time, leveraging our digital capabilities as well as, some of the processes that we put in place.

Michael Lasser (Analyst - UBS):

Are you learning anything about price elasticity? It seemed last quarter it was or focused on the sciences maybe -- this quarter was more and seasonal and pools. And so maybe the construct of the home improvement industry which I -- conventional wisdom says that the elasticity isn't as great here as in other categories. It may not be true and you can push that a little harder to drive more traffic? That -- is that the way you're thinking about it?

Unidentified Company Representative:

So Michael, we've got tools to us to understand the effectiveness of promotions and price elasticity of items. That's the magic is to have the right level of promotions that resonate with customers, not too much [as much] promotion creates some leakage in the system and less then agile flow-through. So we do have some tools in place to allow us to evaluate the effectiveness of the promotion of drawing customers in, try to get a sense of close-rate, as well as the elasticity of the items. So, we are continuing to turn knobs and pull levers to maximize the effectiveness there.

Michael Lasser (Analyst - UBS):

And Bobby, you mentioned that you think promotions will be less of an impact on the gross margin in the second quarter. Is that because you're going to pull back on the promotions? Or you think this will be more effective and less diluted? And then I'm done. Thank you.

Bob Hull (CFO):

Yes, so as Mike said, one of the key areas that was a focus on Q1 was lawn and garden. Some of the higher take-rate and higher effective promotions were around that category. Those are not things we expect to repeat in the second quarter or beyond for that matter regarding lawn and garden, which allows us to be comfortable with that -- the impact is largely contingent first quarter.

Michael Lasser (Analyst - UBS):

Okay, good luck with the spring. Thank you.

Operator:

Matthew Fassler with Goldman Sachs, please go ahead.

Matthew Fassler (Analyst - Goldman Sachs):

Thanks a lot and good morning. A couple of quick ones here. I know you give the monthly cadence as reported. Did the Easter calendar shift impact the monthly cadence at all?

Bob Hull (CFO):

It did Matt, as we think about Easter impacted -- with the change, Easter would've impacted March, March would've been 9.7%, April would've been 3.4%.

Matthew Fassler (Analyst - Goldman Sachs):

Got it, that's very helpful. The second question, can you talk about what you saw directionally for online growth this quarter and any changes in how the cat -- how the customer DIY and/or Pro if using low stuff comp?

Robert Niblock (Chairman, President & CEO):

Yes, Matt. Lowe's.com and e-commerce grew 23.5% for the quarter and we saw strong growth in traffic as well as conversion to the sites. We feel good about the investments that we've made over the past year and really beginning to drive increased shop-ability of the site. I think the key aspects there is when we go back and we talk about the things we've done to the site to really make it more customer-friendly.

Like I said in my comments, the enhanced video content that we're adding to the site, the improved product descriptions, as well as an increased content. There is also a resonating wealth of customer. So those aspects of it I think continue to help us drive the incremental growth from the.com platform. Lowe's for Pros, from an e-commerce perspective, is performing extremely well, as we said, exceeding our expectations.

We're extremely pleased with what we were hearing and the feedback we're getting from consumers, as well as our AEP's in the field about the usability of the site. The functions of the site enable us to make the ability for the Pro to shop much more easily with us, so we're really proud of those two things as we continue to [inaudible]. We have not seen a shift in the mix of business regarding the in-store pickup. We still see that as roughly 60% of all e-commerce transactions that are picked up. That's even heavier as it relates to Lowe's for Pros. Delivery still continues to grow as a component of that, and parcel is about 30% of our .com sales.

Matthew Fassler (Analyst - Goldman Sachs):

Thanks so much for that through answer, I appreciate it.

Operator:

Seth Sigman with Credit Suisse, please go ahead.

Seth Sigman (Analyst - Credit Suisse):

Thanks, good morning. So one follow-up question on the gross margin, in the past you guys have talked about some offsets in either product cost, deflation or value improvement, which I don't think was called out in the quarter. Can you speak to those items and if you see that as -- those as bigger opportunities as we move through the year?

Bob Hull (CFO):

So Seth, those items continue to be in play. We did see some modest benefit from both of those items in the quarter, but they were off-set the three negative factors that were mentioned.

Seth Sigman (Analyst - Credit Suisse):

Got it, okay. Then just a specific question on the appliance category. I think that category saw one of the biggest swings in the quarter, went from outperforming in the past to below the company average and I think that's just [optics] to some extent as I think you said the category was still up mid-single digits, but is there anything else to read into that as we try to understand both where we are in the cycle, and also perhaps how the competitive landscape may be changing in that category specifically? Thanks.

Unidentified Company Representative:

No, we don't think there's anything else to read into it. If you look at our appliance business, it's outperformed for the last quarters. It's a cycling over a double-digit comp. The two-year stack is well above the Company average. We continue to have one of the assortments with all of our national brands. We continue to take advantage of next delivery, haul away and house facilitation, repairs and maintenance. We're really proud of the fact that we control the last 3 feet of the appliance experience. We don't outsource that.

J.D. Powers just recognized us as the best in appliance retail satisfaction. The investment that we made in floor space gives us one of the largest floor space in the industry. And the reason why we think that's important is that if you consider our floor space and appliances coupled with our floor space and cabinets, it positions us well to take advantage of the cycle as 2016 [used] to play through.

The last thing I say is that in kitchens in particular, if you look at the high-ticket items in kitchen, things like cabinets and counter tops, we saw strength there. So that suggests to us that the cycle is still well intact.

Seth Sigman (Analyst - Credit Suisse):

OK, makes sense, thanks very much.

Operator:

Mike Baker with Deutsche Bank, please go ahead.

Mike Baker (Analyst - Deutsche Bank):

Thanks, one follow-up question to an earlier one. How much did the greater uptake on the promotional activity impact the comps?

Unidentified Company Representative:

Certainly had some impact Michael as lawn and garden is one of the best performing categories, so it was certainly a driver of the quarter. But as the team described, there's many actions impacting the Pro, impacting the paint category, impacting a variety of things to help drive the totality of performance in the quarter.

Mike Baker (Analyst - Deutsche Bank):

Okay, I think that the four product categories that I think it was Mike Jones mentioned as, where you focused promotions to or above to or below Company average. So, I was looking for more color on that, but okay, understood.

Another question, you did keep the 80 to 90 basis points guidance for the year on the margins, which means for every comp point above 1%, that you're going to look for between 27 and 30 basis points of improvement and you're obviously below that here. So, is the reason that you have changed that -- is it what you said earlier about not changed the comp outlook, just too early in the year or are there specific reasons to believe the flow-through will be not only better than it was in first quarter, but better than that 27 to 30 typical rule of thumb.

Unidentified Company Representative:

So I just would say Michael, we think there's descent -- [scheduled upsite] on the sales line. Again, we feel good about the demand we saw in Q1. We hope to sustain the momentum, however we feel it's way too early to start thinking about changing outlook for the year. So we do think there's some upside on the top-line.

We talked about some gross pressure in the first quarter that won't continue. So, we'll certainly taking that into account, however we do feel even better then we did 90 days ago but our ability to continue to drive [expense] productivity and leverage, which gives us conference in the outlook.

To the extent sales are better and some of that's driven by lumber and [controls] categories and the flow-through Michael closer to 25 basis points. But again, it's too early to start changing pieces of the outlook.

Mike Baker (Analyst - Deutsche Bank):

Okay, thanks, understood.

Unidentified Company Representative:

Thank you, Mike.

Operator:

Eric Bosshard with Cleveland Research Company, please go ahead.

Eric Bosshard (Analyst - Cleveland Research Company):

Two things. First of all, from a bigger picture perspective, I just wondered Bob if you could comment on how we should be thinking about gross margin, understand the moving parts of the first quarter, but as we think about this year or the next couple of years, strategically how are you thinking about balancing promotions and sales relative to gross margin and what path does that suggest for gross margin?

Bob Hull (CFO):

So, two things. One that ties back to a previous answer. And the second would be long-term gross margin performance. So as I mentioned earlier, we do have tools that allow us to evaluate the effectiveness of promotions. As we think about promotions, some are to drive -- specifically drive sales, some are specific to throw in the basket and some are just general awareness around the brand and the categories we carry.

So we continue to turn knobs and pull levers to back-slice the effectiveness there. Taking a step back

Eric, as we think about gross margin, we do expect some modest gross margin improving annually. As we think about gross margin, it's probably not going to be 2017 until we actually eclipse the gross margin rate we had in 2010. So, it's not like we're [forting] new ground and looking for gross margin peaks that have never occurred before. So roughly over that 8-year period, it's called flash gross margin over a long period of time.

Eric Bosshard (Analyst - Cleveland Research Company):

And then secondly, I understand the influence of weather and your desire to not talk about the very near-term, but the difference in performance in April and May relative to February and March, anything that you learn in looking through that? Can you isolate the weather? Is there anything else that's going on that explains the magnitude of the step down?

Unidentified Company Representative:

Two things regarding weather. So I mentioned 150 basis point effect for the quarter. If you exclude the weather, we would still beat our sales plan. So its underlying demand for our category is from macro fundamentals that drive our business. Housing and incomes continue to be constructed. Beyond that, no other nuances impacting the quarterly -- excuse me -- the monthly cadence.

Eric Bosshard (Analyst - Cleveland Research Company):

Okay and within -- I guess your commentary within April being on plan would suggest that's you expected to be despite whatever happened with weather. Is that the proper way to read that?

Unidentified Company Representative:

That is correct.

Eric Bosshard (Analyst - Cleveland Research Company):

Okay, thank you.

Operator:

Seth Bashum with Wedbush Securities, please go ahead.

Seth Bashum (Analyst - Wedbush Securities):

Thanks and good morning. My first question is just around Pro and specifically, Lowe's for Pros. You've had that in place now for a couple of quarters. Could you give us an update on the effectiveness and attraction you're gaining from that initiative?

Robert Niblock (Chairman, President & CEO):

Sure, as I stated earlier, we've been very pleased with the receptivity from the consumer and the Pro customer regarding Lowe's for Pros. We continue to see strong growth quarter-over-quarter as the customers come aware of the site. If you want to look at Q1, we saw a significant growth in new registered Pros on the site, as well as conversion and growth as a percent of total .com business. So we feel great about what we're seeing.

We continue to improve the functionality of the site through feedback from our customers and our sales teams to make it more conducive and easier for the customers to navigate. The other thing I would say is we continue to look at the site is to keep in mind the functionalities that it did provide that we did not have the capabilities of before. So, the Pros for example were not allowed -- were not capable of using their in-house credit. They can now.

Pros did not receive their 5% [Valcrop] usage on prior Lowes.com, they can today. Tax-exempt accounts were unavailable to them prior usage, they are today. So all those things are resonating extremely well and we continue to work on making on the site more effective, more efficient, but to date, we've been extremely pleased with what we've seen both from a registered user content as well as sales performance.

Seth Bashum (Analyst - Wedbush Securities):

Great, that's helpful. Secondly on cost control, great performance this quarter. As you look through the balance of the year Bob, when you think about labor optimization, marketing, indirect costs, can you give us an order of magnitude of the benefits you expect from each of those?

Bob Hull (CFO):

Sure, I'll give you some high-level prospective. For the year, we continue to think indirect spend is going to pay dividends for us, that's in the 50 or so basis point range, bonus is 10. Like we talked about the analysis around promotions, where we continue to do the same thing regarding resets and things of that nature, we think we'll get about 10 basis points of leverage on that spend this year.

Risk insurance is going to be less of a drag, that's about five basis points. Employee insurance also less of a drag, advertising about five basis points. A couple of -- kind of indirect items, fixed cost leverage, 10 or so basis points and the impact of the 53rd week gives us about five basis points. So, a lot of good items to drive the expense leverage for 2016.

Seth Bashum (Analyst - Wedbush Securities):

That's helpful detail, thank you.

Operator:

Kate McShane with Citi Research, please go ahead.

Kate McShane (Analyst - Citi Research):

Thank you, thanks for taking my question. One area that I just wanted to make sure I addressed today is just about the supply chain. I know something that has been discussed by both you and your biggest competitor in the home improvement channel as a competitive advantage and a way to not get disrupted. Can you walk us through any efficiencies achieved in the supply chain this quarter and what opportunities you're working on over the next six to twelve months?

Unidentified Company Representative:

Sure. The aspect of supply-chain has been a significant advantage for us for years as we talk about how we built out supply-chain and the avenues that we have. I think as we look at the Omni-channel environment, over the last several years we've been able - several new functions to the supply chain to allow us to continue to meet that demand. Flexible fulfillment, which allows us to ship from a store group, as well as our RDC's. So, we're able to meet 94% of all customer demand with next day shipping rates, by utilizing that flexibility within the system.

We continue to maximize the productivity of the supply chain through new initiatives, such as Project Rhythm, which we work with vendors in smoothing out orders and order flow to make sure that we're as effective as possible. We continue to drive labor efficiency in the supply chain through utilization of Lean Six Sigma practices and processes, and making sure that we're able to get the effective use of cubing-out the trailers and the trucks to move forward. Fleet and fuel costs continue to be an advantage and a tailwind currently. So, we continue to see those avenues playing significant dividends for us over the next several months, and quite frankly, the next couple of years.

As we look into the construction -- possibly -- the internet fulfillment center or DSC, direct-to-customer fulfillment center which we have currently plans underway and being built out for a forecasted opening in the 2018 time horizon.

Kate McShane (Analyst - Citi Research):

Thank you.

Unidentified Company Representative:

(Operator), we have time for one more question.

Operator:

Peter Benedict with Robert Baird, please go ahead.

Peter Benedict (Analyst - Robert Baird):

Hi guys, thanks for taking one more year. So a couple of questions. First, the comment about Pro being well above the company average, I know it was above average in the fourth quarter, but it sounded obviously the sound of that comment was a lot stronger. Any way to quantify that -- this gap relative to maybe historical trend? Is this about as strong a gap as you've seen? I'm just trying to get a flavor for just how strong that momentum is right now.

Bob Hull (CFO):

So the Pro performance Pete in first quarter was approaching double-digits.

Peter Benedict (Analyst - Robert Baird):

Okay, good, that's helpful Bob, thank you. And then on the online business, what are the largest categories that you guys are selling online right now? And then, what are the fastest-growing? I mean, are there certain categories that are kind of coming on strong, just curious how that looks?

Bob Hull (CFO):

A couple things. I'd say for the most part where you see [simple, replaced] items, they tend to do better on-line, like appliances as an example. But one of the differences in our strategy is that we help customers put together projects, and that tends to lend itself more towards Omni as the best tool to serve those customers needs.

But our incursion of on-line is moderated by the fact that we tend to be more project-oriented then simple replace, thus we talk about being the project authority and not -- and not talk to just products.

Robert Niblock (Chairman, President & CEO):

Yes and more to add to that, as we continue to look at overall traffic to the site, as I said earlier, we've been extremely pleased with receptivity to new functionality of the site from the consumer. I think that's representative in the results over the last couple quarters, as well as the investments that we're making to make content more effective for the customers from a arrogation of data perspective, as well as a product information. As such, we've been extremely pleased with the sales from the site.

The visits to the site have continued to grow, as well as improvements in conversion and average ticket. So as Mike talked about, we continue to see those core fundamental categories continue to do well, the single product categories particularly in appliances and those categories.

And again, I think it's important to highlight that the store still plays a critical role in the Omni-channel, where our customers are choosing to either pick-up or have delivered 70% of all of our transactions from Lowes.com, from the store, with 30% still be in parcel. So, we feel good with where we are, we feel good with the traction we're making and making the site much more effective and user-friendly.

Peter Benedict (Analyst - Robert Baird):

Very helpful. Last part would be on lawn and garden, obviously strong in the quarter but I'm curious about the spread north versus south. I mean certainly a lot stronger in the south I think then the north. How large was that gap and what kind of opportunity do you see in lawn and garden, in call it the North, Northeast over the balance of the second quarter? Thank you.

Unidentified Company Representative:

So we think spring is still to come, in the Northeast so -- so we think there's still some lawn and garden business to go get. But I do want to just say one thing. If you think about our business, we had some [swamp motions] in lawn and garden. The rest of our business continues to do extremely well. So if you look at paint as an example, where we have really high comps above the Company average; applicators, exterior paints, spray paint, call it interior stains, all double-digit.

So, we feel good about some of the spring that's ahead of us. We think that's going to drive our lawn and garden business. We feel even better about some of our big initiatives that are also driving our business.

Peter Benedict (Analyst - Robert Baird):

Terrific, thanks so much guys.

Robert Niblock (Chairman, President & CEO):

Thanks for your continued interest in Lowe's. We look forward to speaking with you again when we report our second quarter results on Wednesday, August 17. Have a great day.

Operator:

Ladies and gentlemen, this concludes today's conference. Thank you all for joining and you may now disconnect.