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Q2 2020 Earnings Call

Company Participants

- Ann-Marie Campbell, Executive Vice President - US Stores
- Carol B. Tome, Chief Financial Officer and Executive Vice President-Corporate Services
- Craig Menear, Chairman, Chief Executive Officer and President
- Isabel Janci, Vice President, Investor Relations
- Mark Holifield, Executive Vice President-Supply Chain & Product Development
- Ted Decker, Executive Vice President of Merchandising

Other Participants

- Charles Grom, Analyst
- Christopher Horvers, Analyst
- Greg Melich, Analyst
- Karen Short, Analyst
- Michael Lasser, Analyst
- Scot Ciccarelli, Analyst
- Seth Sigman, Analyst
- Simeon Gutman, Analyst
- Steve Forbes, Analyst
- Zach Fadem, Analyst

Presentation

Operator

Greetings and welcome to the Home Depot Second Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host Isabel Janci. Please go ahead.

Isabel Janci {BIO 20990226 <GO>}

Thank you and good morning, everyone. Joining us on our call today are Craig Menear, Chairman, CEO and President; Ted Decker, Executive Vice President of Merchandising; and Carol Tome, Chief Financial Officer and Executive Vice President, Corporate Services. Following our prepared remarks, the call will be opened for questions. Questions will be limited to analysts and investors. And as a reminder, please limit yourself to one question

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with one follow-up. If we are unable to get to your question during the call, please call our Investor Relations Department at 770-384-2387.

Before I turn the call over to Craig, let me remind you that today's press release and the presentations made by our executives include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. These risks and uncertainties include but are not limited to, the factors identified in the release and in our filings with the Securities and Exchange Commission. Today's presentations will also include certain non-GAAP measures, reconciliation of these measures is provided on our website.

Now let me turn the call over to Craig.

Craig Menear {BIO 15126612 <GO>}

Thank you, Isabel and good morning, everyone. Sales for the second quarter were $30.8 billion, up 1.2% from last year. Comp sales were up 3% from last year with US comps of positive 3.1%. Diluted earnings per share were $3.17 in the second quarter. We are pleased with these results. We overcame a tough May and continued lumber price deflation to deliver accelerating comp performance throughout the core. Looking at our results geographically, all of our US divisions posted positive comps. 17 of 19 US regions also posted positive comps with the exceptions being our Gulf and Florida regions, which delivered high storm-related comps last year.

Internationally, Mexico posted high-single digit positive comp and Canada posted low-single digit positive comp, both in local currency. We saw broad-based growth across the stores; both comp ticket and transactions grew. With the exception of lumber, all of our merchandising departments posted positive comps. We saw a healthy balance of growth among both Pro and DIY categories, with Pro sales outpacing our DIY business in the US. As Ted will detail, we continue to invest in a portfolio of service offerings to deepen our level of engagement with the Pro. We know that the more dimensional our relationship is with this customer, the more they spend.

From a strategic perspective, I'm encouraged by the progress we are making to deliver the One Home Depot experience, a seamless interconnected shopping experience for our customers. Our in-store investments are focused on ease of navigation and improved speed to checkout. We have implemented our wayfinding sign and store refresh package in over 1,400 of our US stores. And customer service scores in the category of neat and clean have increased 140 basis points. Our front-end store investments now in over 400 stores are designed to get customers in and out stores faster and they are doing just that. Customer service scores and checkout time satisfaction have increased over 450 basis points versus last year.

While our stores remain the hub of our business, we know that many of our in-store sales are influenced by online visits and approximately 50% of all online US orders were picked up in our stores during the quarter. Our customers continue to blend the channels of

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engagement and we are investing to remove the friction as they do so. We continue to roll out automated pickup lockers for online orders with over 1,100 stores completed and have seen a 250 basis point increase in checkout scores for stores with lockers versus those without. Our investment in the digital price labels for our appliance department has enabled us to incorporate ratings and reviews from the digital world into the store shopping experience, enhancing the overall customer experience in the category.

As we invest to address the unique demands of an interconnected customer experience in stores, we also continue to invest in our website and mobile applications to further enhance the digital customer experience. Our focus on improving search capabilities, site functionality, category presentation and product content has yielded higher traffic, better conversion and continued sales growth. Second quarter online sales grew 20% from the second quarter of 2018. We also continue to leverage our digital platforms to drive incremental growth from new categories as we lean into adjacencies like HD Home, pool and workwear. The traction we are seeing from the investments across our digital and physical assets are encouraging not only from a customer experience standpoint, but they are also driving productivity throughout the business.

Our front-end investments are optimizing labor and merchandising space productivity. Digital appliance labels enable associates to be more productive with their time. Instead of spending multiple hours manually changing price signs, our associates can reallocate their time to engage with customers in a high touch category. The virtuous cycle of productivity at the Home Depot has been a hallmark of our operational excellence over the years and continues as we move forward. Our focus on enhancing the customer experience and end-to-end productivity extends to the supply chain investments as well. During the quarter, we completed the retrofit of our Hagerstown facility into a parcel direct fulfillment center, which expands our one day delivery capabilities or stock parcel goods from approximately 30% to approximately 50% of the US population.

We also drove productivity and cost out through our mechanization efforts in our upstream supply chain. We are on track with our plans to create the fastest most efficient delivery network in home improvement and are pleased with the progress that we have made thus far.

Turning to our outlook for the remainder of the year, the building blocks of our financial model remain in place. As Carol will detail, we are lowering our sales guidance for the year, mostly to reflect the impact of lumber price deflation, as well as some conservatism to account for the recently announced tariffs. We now expect this fiscal 2019 comp sales growth of approximately 4% and reaffirm our expectation for diluted earnings per share of $10.03.

I want to close by thanking our associates for their hard work, which resulted in the highest quarterly sales in our Company history. And with that let me turn the call over to Ted.

Ted Decker {BIO 16614891 <GO>}

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Thanks, Craig and good morning, everyone. While we had a slow start to the second quarter, we were pleased to see demand accelerate throughout the quarter, as we help our customers tackle a variety of interior and exterior projects. Looking at our departments, comps in appliances, tools, decor and storage, indoor garden, building materials, paint, outdoor garden, hardware and plumbing were above the Company average. All other departments with the exception of lumber were positive, but below the Company average.

Lumber reported a high-single digit negative comp due to commodity price deflation. Second quarter comp average ticket increased 2% and comp transactions increased 1%. Lumber prices remain depressed during the second quarter and as a result lumber negatively impacted our average ticket growth by approximately 110 basis points. Last quarter, we talked about a 4x8 sheet of OSB selling for about $8, more than 50% below the price a year ago.

During the second quarter, the price for that same sheet of OSB fell further to an average of about $7.60. During the second quarter, big ticket comp transactions, or those over $1,000, which represent approximately 20% of US sales, were up 3.7%, reflecting in part, the impact of hurricane-related sales last year and lumber price deflation. Excluding hurricane-related markets only, big ticket transaction costs were nearly 5%. During the quarter, we saw strong performance in big ticket categories like appliances, vinyl plank flooring and patio.

Last quarter, we talked to you about opportunities in our flooring business. While vinyl plank has been and continues to be one of the strongest performing product categories across the store, we identified a need to refine our assortment within our other flooring categories. For example, in special leather carpet, we've recently taken several actions. We upgraded all of our showrooms and reset the category to reflect the latest styles and trends while offering a simpler shopping experience showcasing a good, better, best line structure. Given the associate engagement, it's extremely important for this category, we also enhanced our in-store training efforts to drive better customer shopping experience. While early days, we're pleased with the results.

During the second quarter, we saw growth in both our Pro and DIY customers with Pro sales outpacing DIY sales in the US. We continue to focus on our suite of Pro initiatives because we know that the more we engage with them, the more they spend with us. We've equipped our store associates with a number of tools and to better understanding their top Pro customers. Our my view system allows our Pro sales associates to access customer data and information, so they can proactively work with our Pro customers and determine how we can better serve them. We continue to simplify the Pro shopping experience and expand engagement through services like tool rental, delivery and our new B2B online experience.

While May was another wet month, we saw project demand in outdoor categories rebound as weather improved. Categories like concrete, exterior paint and stains, live goods and mulch had comps above the Company average. In addition, we continue to see customers respond to our industry-leading brands and the innovation they are bringing to market. In our outdoor power equipment business, we are seeing strong

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customer demand and continued trade up to cordless tools like blowers, trimmers and even lawnmowers. Exclusive cordless product for brands like Ryobi, Milwaukee, DEWALT and EGO provide our customers with superior functionality and run time to keep their yards looking great.

Switching gears, as you heard from Craig, we are happy with the progress we are making with our investments to deliver best-in-class interconnected shopping experience. Looking at our likelihood to shop again metric, 87% of our customers give us a best-in-class score of 5. Our strategic investments include accelerated merchandising resets focused on upgrading showrooms, improving visual merchandising and refining assortments to drive a better in-store shopping experience. For example, we are rolling out a new color solutions center in our paint department, which simplifies the color selection process for our customers, while emphasizing our price, color and satisfaction guarantee. And our new project Color App and updated online experience allows our customers to seamlessly explore the inspired and shop color online whenever or wherever they want. Another example is in pipe and fittings. We are resetting all of our base, reconfiguring them to better showcase the assortment in freeing up space to add new product categories for our customers.

Now, let's turn our attention to the back half of the year. As the number one retailer of ladders, we are pleased to announce an expansion of our partnership with Werner, the number one brand for Pro's. Multi position ladders are the fastest growing segment in the ladder category and we are now the exclusive big box retailer of Werner multi-position ladders. We are also happy to announce an exciting new partnership with Louisville Ladder, as their exclusive big-box retailers starting in the fourth quarter. Combining Warner with our exclusive Louisville ladder and Gorilla brands, we are the leading destination for top Pro brands in the ladder category. Our merchants have worked hard to put together events and special buys for our customers in the third quarter. We are excited about our customers' continued appetite for home improvement projects and in just weeks, we will host our Annual Labor Day event followed by our Halloween Harvest event.

With that, I'd like to turn the call over to Carol.

Carol B. Tome {BIO 1907475 <GO>}

Thank you, Ted and good morning, everyone. As you will recall, fiscal 2018 had a 53rd week, which shifted our fiscal 2019 calendar. Our comp sales are reported on a like-for-like basis, but total sales growth is reported on a fiscal year basis. In the second quarter, total sales were $30.8 billion, a 1.2% increase from last year, reflecting the shift in our fiscal calendar, as well as the impact of deferred sales. Our total Company comps were positive 3% for the quarter with positive comps of 0.2% in May, 4.1% in June and 4.6% in July.

Comps in the US were positive 3.1% for the quarter, with positive comps of 0.6% in May, 4.1% in June and 4.7% in July. Versus last year, a stronger US dollar negatively impacted comp sales growth by approximately $29 million or 0.1%. As you just heard from Ted, during the second quarter lumber prices remain depressed versus last year, this lumber

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price deflation negatively impacted our comp sales growth by approximately $340 million or over 100 basis points.

In the second quarter, our gross margin was 33.8%, a decrease of 19 basis points from last year. The year-over-year change in our gross margin reflects the following factors. First, higher shrink than last year resulted in approximately 9 basis points of gross margin contraction. Second, changes in the mix of products sold drove approximately 8 basis points of gross margin contraction. And finally, we have 2 basis points of gross margin contraction in our supply chain, driven primarily by start-up costs associated with our One Home Depot supply chain initiatives.

In the second quarter, operating expense as a percent of sales at 18% was essentially flat compared to last year. Our operating expense performance reflects the impact of our strategic investment plan and good expense control during the quarter. Specifically expenses related to our strategic investment plan of $242 million increased by approximately $28 million from last year and resulted in approximately 8 basis points of operating expense deleverage. This deleverage was offset by productivity in BAU or business as usual expenses, which drove 7 basis points of operating expense leverage. Our operating margin for the second quarter was 15.9%, a decrease of 21 basis points from last year.

Interest and other expense for the second quarter grew by $37 million to $283 million, due primarily to higher long-term debt levels than one year ago. In the second quarter, our effective tax rate was 24.6% compared to 24.7% in the second quarter of fiscal 2018. For the year, we now expect our effective tax rate to be approximately 25%. Our diluted earnings per share for the second quarter were $3.17, an increase of 3.9% from last year.

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Now moving to some additional highlights. During the quarter, we opened two new stores, one in the US, and one in Mexico. For an ending store count of 2,291. Selling square footage at the end of this quarter was 238 million square feet. Total sales per square foot for the second quarter were $510, up 1.1% from last year. At the end of the quarter, inventory turns were 5.1 times, down from 5.4 times last year reflecting in part a load in of inventory in support of our strategic initiatives. For the year, we now expect our inventory turns to slow slightly from what we reported in fiscal 2018.

Moving on to capital allocation. In the second quarter, we repurchased $1.25 billion or approximately 6.3 million shares of outstanding stock. We plan to repurchase approximately $2.5 billion of outstanding shares in the second half of the year, bringing fiscal 2019 share repurchases to $5 billion in line with our guidance. Further during the quarter, we took advantage of an attractive interest rate environment and raised $1.4 billion of long-term debt, of which $1 billion was used to repay senior notes that came due in June. Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 43.7%, 580 basis points higher than the second quarter of fiscal 2018.

Now turning to our outlook for the remainder of the year, while global economic pessimism has increased due to geopolitics, currently the US consumer remains healthy.

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Consumer confidence is near record high level and wages are up over 3% from last year. Housing metrics are in line with the assumptions we used to build our 2019 financial plan. Nonetheless, what we didn't expect when we built our plan was the significant lumber price deflation we've experienced. We are now more than halfway through the year and lumber prices are below the levels we saw in the first quarter of fiscal 2019. Additionally, the US consumer is facing the impact of tariffs, while trade discussions are fluid, consumer demand could be impacted.

Today, we are updating our fiscal 2019 sales and earnings per share of growth guidance to reflect these changes. Remember that we guide off GAAP, So fiscal 2019 guidance will launch from our reported results for fiscal 2018, which includes sales and earnings associated with the 53rd week. For fiscal 2019, we now expect comp sales is calculated on 52-week basis to increase by approximately 4%, that's down 100 basis points from the 5% growth rate we planned at the beginning of the year, reflecting for the most part, lower lumber prices, as well as some potential impact to the US consumer from recently announced tariffs.

With this, we now expect sales to increase by approximately 2.3%, reflecting the compare to 53 weeks Last year. We are also reaffirming our earnings per share growth guidance for fiscal 2019. For earnings per share, we expect fiscal 2019 diluted earnings per share to grow approximately 3.1% to $10.03. We are able to hold our earnings per share guidance to what we initially planned, as lumber is a lower margin category and because we are projecting a lower tax rate than our original plan.

We thank you for your participation in today's call. And Christine, we are now ready for questions.

Isabel Janci {BIO 20990226 <GO>}

Christine, before we open the call up for questions, I'd like to turn the call back over to Craig.

Craig Menear {BIO 15126612 <GO>}

Thank you,, Isabel. As I mentioned on our last earnings call, Carol Tome will be retiring as our CFO at the end of this month after 24 years with the Company. She has served as our Chief Financial Officer for the past 18 years. And in fact today's call is the 73rd consecutive quarter she has reported our financial results to the market. I'd like to thank Carol for her deep commitment to our associates, the investment community and our shareholders. Carol has set the standard for excellence and transparency during these calls, reflecting not only her in-depth knowledge of our business, our operating environment, the economic environment, but also her dedication to our values. So Carol, let me say thank you for your leadership and through your partnership in your 24-year career at Home Depot. You will definitely be missed. Christine?

Carol B. Tome {BIO 1907475 <GO>}

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Thank you, Craig. And we will try to get some questions without me crying.

Questions And Answers

Operator

Thank you. We will now be conducting a question-and-answer session (Operator Instructions) Thank you. Our first question comes from the line of Michael Lasser with UBS. Please proceed with your question.

Q - Michael Lasser {BIO 7266130 <GO>}

Good morning. Thanks a lot for taking my question. That's a hard lead-in to ask a question off of when Carol...

A - Craig Menear {BIO 15126612 <GO>}

Sorry about that, Carol.

Q - Michael Lasser {BIO 7266130 <GO>}

All good. Carol, congratulations and best of luck.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Q - Michael Lasser {BIO 7266130 <GO>}

And you too Richard, good luck in following in those very large footstep.

A - Craig Menear {BIO 15126612 <GO>}

They certainly are --

Q - Michael Lasser {BIO 7266130 <GO>}

So my first question is, we have assumed that about three quarters of the reduction in your full year comp guidance is due to the lumber price changes and the remainder is still about a quarter of a comp point is due to the macro. There's obviously been a lot of concern on the macro recently given the yield curve inverting a large education institute -- institution that's calling for a significant slowdown in remodeling activity, and then as you pointed out, the tariff uncertainty. So do you think a quarter point reduction in your comp guidance sufficiently considers all of those uncertainties?

A - Craig Menear {BIO 15126612 <GO>}

So Michael, let me make a couple of comments and I'll turn it over to Carol. So first of all, when you look at the overall macro factors that we think are critical to how we line up our business. Those have largely remain unchanged. And so we feel good about the fact that

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the consumer has wages up about 3% year-over-year, consumer confidence is still high, so the general trend that we see in the macro-based on how we did our plans really hasn't changed much and we feel pretty good about that. And then when you think about going forward in the business, when we looked at commodity, hurricane, May and then compared that to where we were at the end of the quarter, we feel good about the guidance that we have.

A - Carol B. Tome {BIO 1907475 <GO>}

Yeah. Let me give -- sure, I'll give you a little bit more color there, Michael. So the implied back half comp and the guidance that we just gave you was around 5%. If you look at our reported comp in the second quarter in US, it was a 3.1% comp. If you add back the impact of hurricane-related sales, that was 50 basis points of hurt. If you add back the weather driven demand, softness that we saw in May, that was 40 basis of hurt -- 40 basis points of hurt. And then you've heard us talk about commodity, I think 100 basis points. So when you add that back, actually the normalized comp in the second quarter was 5%.

Then you heard Craig [ph] talk about the comp cadence that we exited July quite strong on an unadjusted basis, the comps in the US was 4.7%. And then, I look at our -- how we're performing relative to plan and we're on our plan. So you add up all the data points and it suggests that this -- is just -- the comp guidance is very achievable. And the other way to look at it is, just stack the comps. If you stack the comps for the first half of this year against last year, back to second half what we reported and what we're guiding to, the stacked comp is about the same in both of the halves. So every way we look at it, we feel very good about the guidance that we've given.

A - Craig Menear {BIO 15126612 <GO>}

Michael, I guess the last comment that I have on it, if consumer softened in anyway, I'll bet on this team all day long to go after the business.

Q - Michael Lasser {BIO 7266130 <GO>}

No doubt. And Carol you mentioned you're on your plan, do you mean you're on your plan where you stand quarter-to-date such that you really haven't seen any impact from the tariffs flowing through to the consumer as of yet?

A - Carol B. Tome {BIO 1907475 <GO>}

Yeah. That's exactly what I mean. The beauty of our business is that we see sales on our phone. We can know exactly how we're doing by the minute. So that's very different than that leading indicator of remodeling activity report that you just mentioned, which is based on a biennial survey of housing data coming out of (inaudible). We have real data at our fingertips. So we feel good about the performance.

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Q - Michael Lasser {BIO 7266130 <GO>}

You might want to remove that app by the end of the month. And then my last question is on as you look at your guidance for the back half of the year, how should we model gross margin and SG&A, particularly between the third and the fourth quarter recognizing that it's not so straightforward given that you'll be lapping the extra week in the fourth quarter of last year?

A - Carol B. Tome {BIO 1907475 <GO>}

Yeah. So if (inaudible) would talk to expenses, and as we told you we expect our expenses on existing a 52-week to 52-week basis, excluding the write-down that we took for some trade names that we're no longer using, we told you that our expense growth factor would be 90% for the year. For the first half, it was around 73%. So it will be a little bit higher rate in the back half. And quarter-over-quarter expect Q4 to be higher than Q3.

On the gross margin side, as we've indicated, our gross margin, it won't be as low as we had anticipated at beginning of the year because of the penetration shift in lumber. So we will be slightly higher than our original guide. Our original guide was to be flat, down to 34% for the year as you recall. So it won't be down as much. So the second half margin will be down as much as the first (inaudible).

Q - Michael Lasser {BIO 7266130 <GO>}

That's helpful. Thanks again and best of luck.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Operator

Our next question comes from the line of Simeon Gutman with Morgan Stanley. Please proceed with your question.

Q - Simeon Gutman {BIO 7528320 <GO>}

Thank you. Good morning,, everyone. And well done Carol congratulations. My first question is on the second half. I know you don't provide quarterly guidance, but can you share some cadence around the second half comp guidance and it's dependencies? And I'm thinking about macro dependencies and strategic initiatives, and if you can share with us part of it on the strategic initiatives, which ones are expected to contribute to the most of the second half comps?

A - Carol B. Tome {BIO 1907475 <GO>}

A couple of things to think about the second half comps. First, as you know, we're lapping $800 million of hurricane-related sales, of which $500 million occurred in the first half, $300 million in back half. So the hurricane sales overlap is easier. Secondly, on lumber price deflation, let's assume a number of $800 million to make it simple; about $500 million of that occurred in the first half. So, $300 million will occur in the back half. So it is easier too. Then we have the impact of our strategic initiatives (Technical Difficulty).

A - Craig Menear {BIO 15126612 <GO>}

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Yeah. And so on the initiatives, when you think about the Pro, first is the B2B website that we have launched, and we are seeing Pros that have been migrated onto the website, react very positively from a sales standpoint. We are on track for the million Pros in 2019, as a matter of fact, with the tail end of this quarter, we added a significant number of Pros to the website. As Ted detailed My View capability that we've given to our associates in-store to better understand how we can engage with the Pro customer is delivering the results as well.

And then, we've made significant investments in our rental business, which we know is an important aspect for the Pro. 25% of the Pros rent from us today, we know that 90% of Pros rent tools. So we have an opportunity as we invest in this business to continue to grow. And then in the digital investments, our HD Home program as we expand categories to fulfill rooms in the home, as well as the investments we're making in search capabilities, category updates are all leading to improved sales and conversion in the business.

And then the number of investments that we've made in the store as well whether that's our overhead management, which is driving productivity in the store, our interconnected lockers which is enhancing the pickup experience for our customers or our merchandising resets are paying off in a nice way. I don't know, if you want to give a little more color on the reset.

A - Ted Decker {BIO 16614891 <GO>}

Yeah. On the resets, we've been working on our appliance resets and our tool crowds [ph] for some time. Those two businesses continued to post incredibly strong results, and we don't see that changing in back half. More recently, we've been working through our pipe aisle reset, which is going extremely well to about half the chain this year and that adds holding power and room for some new assortment programs.

And then soft flooring, I mentioned in our prepared remarks, for a while (inaudible) soft flooring losing all ground to hard surface flooring what we've seen in solid floor vinyl and tile. But resetting all of our soft carpet showrooms those are done, we simplified our brand structure, we simplified our line structure and pricing structures that has continued to accelerate through the quarter and exited the quarter at much higher than the Company comps. So we're happy with what we're seeing in soft flooring.

And then lastly, our largest reset to comp, which we've just launched in the last several weeks and we will finish the entire chain by the end of this year is our new color solution center in our paint department, where we'll be highlighting our Behr and PPG products and really pleased with that the timing couldn't be better with a number of recent consumer surveys and consumer testing agencies release the new winners for this year and Behr captured the top three paint products in the entire industry at the best value and PPG posted the two top stain products at the best value. So we're very excited about all those resets, Craig?

A - Carol B. Tome {BIO 1907475 <GO>}

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And Craig, just to add a couple of points from just driving new customer experience as well. Number one, you mentioned the rental, we are continuing to see growth accelerate from half to half. So the investments we're making there are really driving exponential value and so we're going to continue to lead in there. To the points about driving the events in the second half, when we think about our comp cadence. Craig talked about overhead management and our ability to find a product and get or on shelf availability to a very, very high level is driving incremental performance.

And for us, as we think about the investments, not only to get into product on the shelf, it's how do we get the customers to the store. So we have done 450 front-end transformation. We have heard the numbers that we have seen just the customer experience grow across the board. We're going to have over 800 by the end of the year. And so we're able to deliver this performance by not only transforming our business but making sure that we're focused a simple and direct and drive into where the customer expects us to be. So we will continue to drive through that in the second half of the year and leverage the events to drive exponential differentiated performance.

Q - Simeon Gutman {BIO 7528320 <GO>}

Thank you. That was very comprehensive. Can I -- I'm going to ask my follow-up. A year ago, when rates were rising, we went through this hypothetical scenario, if we saw a recession. I think we talked about a scenario in which Home Depot would comp flat and margins could go to 12%, if you made all the investments as part of your plan. I think, we're now -- one year forward you're making progress on margins. Can you provide us another update with your margin end up better than that 12% given that you're closer now to some of your goals?

A - Carol B. Tome {BIO 1907475 <GO>}

Well, Simeon we haven't updated that recession model. Productivity is a virtuous cycle at the Home Depot. But for modeling purposes, I would use the same numbers that we shared with you before. And just on the sort of the state of the economy and when a recession might happen, we certainly can't predict that. But we know a few things, we are in the longest economic recovery in our nation's history. And yet the amount of growth during this recovery is still under the average of every other recovery industry. So this is one reason why it's been an elongated cycle. Further, the share of housing as a percent of GDP has dropped. Its about 90% of GDP. Back in 2006, it was about 22% of GDP. So whenever that downturn comes. Then simply it is cyclical (inaudible) is about. Whenever that downturn comes, it's not going to be like it was before. So we're very well positioned just to manage through all that.

Q - Simeon Gutman {BIO 7528320 <GO>}

Thank you, again and best of luck.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

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Operator

Our next question comes from the line of Scot Ciccarelli with RBC. Please proceed with your question.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Good morning, guys. I had another follow-up on the investments that you're making, despite the pretty comprehensive answer you already provided. Can you help us better understand the cadence of the comp growth improvement that you're expecting, both in the back half of this year and that flows into next year front, specifically targeted to these investments?

A - Craig Menear {BIO 15126612 <GO>}

Well, we said in earlier statements that we believe that we will achieve about 1% impact in the back half of the year from the investments that we're making. When you took GDP, the housing benefit and then added in the investments that's how we got to our growth overall. And the only thing that's changed (inaudible) inflation in a moment.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Just to clarify, I think it was one point for the year, all of which is kind of loaded into the back half or did I misunderstand that?

A - Carol B. Tome {BIO 1907475 <GO>}

You're right. It's loaded into the back half and the way that we've modeled it, based on events as well as the completion of resets that you've heard from Ted, is that the fourth quarter comp will be fine [ph] limited.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Got it. And we should presume that because of the changes in that customer interaction, lot of these improvements should flow into next year or is there a point where you start to anniversary and it levels off? Thanks.

A - Craig Menear {BIO 15126612 <GO>}

Yeah. It will definitely flow into next year. We'll get to that guidance later in the year.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Understood. All right. Thanks guys.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Operator

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Our next question comes from the line of Christopher Horvers with JPMorgan. Please proceed with your question.

Q - Christopher Horvers {BIO 7499419 <GO>}

Thanks. Good morning, everybody. And I certainly echo Craig's comments and wish you Carol, the very best of fortune in the next stage of your life. In terms of my questions and just still follow-up on the macro. On the housing front rates moved around a lot moved down quite a bit. I'm about to reset perhaps, perhaps personally and but pricing has moderated and existing home sales are now picking up. So, is that what you were expecting? And then what are you seeing out there in terms of the -- in the market, say, some of the coastal markets (inaudible) that's really driving the deceleration in pricing and pricing coming down versus other parts of the country. And then related to that on the consumer front, are you seeing anything difference in the consumer around the type of projects that they are taking on or perhaps the trade up versus the value orientation?

A - Carol B. Tome {BIO 1907475 <GO>}

On the macro model -- yeah, things are moving around a little bit, but it's just on the margin. So there's no material change to the -- as of the inputs that create the output and drive our sales plan. To your question about the coastal markets, I'll just give you some data. Let's take San Francisco down the coast, the comp was higher than the company average. Let's take San Diego, a little bit further south, comp was at the company average, Let's take New Jersey, which is the high (inaudible) comps were higher than the company average. And then let's just land in Dallas. Dallas has seen a 54% increase in home prices since 2006, and the comp is at the company average. So you can see things are performing the way that we thought they would.

Q - Christopher Horvers {BIO 7499419 <GO>}

Understood. And then a couple of detailed model questions. First, any comment on your expectation for the US comp for the year versus the 4% total guide? And can you help us a little bit more about, on the SG&A in 4Q, right, you gave this 52 to 52-week comparison perhaps how much incremental SG&A dollars there were in 4Q '18 related to that 53rd week?

A - Carol B. Tome {BIO 1907475 <GO>}

So I don't think about answering those questions because we don't like to give too much quarterly information.

A - Craig Menear {BIO 15126612 <GO>}

So the one comment I'd make as it relates to kind of (inaudible) we're expecting positive comps in Canada for the year, if that helps.

A - Carol B. Tome {BIO 1907475 <GO>}

Yeah. The question is what happens to the US dollar and we plan it currency-neutral. So here, you can model what you think, it's going to happen to the dollar and do that in our calculation.

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Q - Christopher Horvers {BIO 7499419 <GO>}

Got it.

A - Carol B. Tome {BIO 1907475 <GO>}

On the expense side, on a reported basis, because of the extra week that expense growth guidance on a GAAP basis look (inaudible) that's still we have explain, it's going to look really below and we are going to ignore that extra week. I think the best thing to do is just work within the annual guidance that we given you and look at it on a 52 to 52 and you can back into what the fourth quarter looks like.

Q - Christopher Horvers {BIO 7499419 <GO>}

Understood. Very helpful. Thanks so much.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Operator

Our next question comes from the line of Charles Grom with Gordon Haskett. Please proceed with your question.

Q - Charles Grom {BIO 1450381 <GO>}

Hey. Thanks. Good morning. Carol, congrats again. So the front half of the year is not been kind on the weather front, we all know that at this point. I'm just curious in the past and you've seen this type of pattern. Do you typically see the release of that demand or do some of the projects just get postponed or canceled altogether?

A - Craig Menear {BIO 15126612 <GO>}

It's by category. So there is some categories that have the ability to extend and we're seeing that in the business right now and so you capture that. There is some or you don't recover all of that business, you might get part of it, but not all of it. So it really varies by category. So if you think about depending on when the weather takes place, you may or may not get a pre-emergent business back, for example. And this year, we didn't get that back.

Q - Charles Grom {BIO 1450381 <GO>}

Okay. Great And then just on the change in the comp guide, when you look ahead to your -- the long-term sales targets of $114.7 billion to it, I believe around $120 billion. I'm just wondering if that changes did that outlook at all or maybe perhaps bring it to the lower end of the (inaudible) equation.

A - Craig Menear {BIO 15126612 <GO>}

Yeah. It definitely goes to the lower end, but it doesn't change the range of guidance.

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Q - Charles Grom {BIO 1450381 <GO>}

Okay. And then just one follow-up on the gross margins, Carol. All of last year transportation was a pretty big headwind, you didn't call it up. This quarter, I don't believe you called it out last quarter. Just curious, if it's actually helping you guys at this point?

A - Carol B. Tome {BIO 1907475 <GO>}

Well, certainly it has moderated from what we saw last year. What we are very excited about is the productivity that we are seeing in our upstream supply chain. Our supply chain team has done a great job of mechanizing our upstream facilities. We actually -- well, I called out two basis points of pressure in the gross margin comp supply chain, upstream we leveraged. We leveraged 6 basis points. So tremendous productivity in supply chain.

Q - Charles Grom {BIO 1450381 <GO>}

Great. Thank you.

Operator

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

Q - Zach Fadem {BIO 18911015 <GO>}

Hey. Good morning, Craig you specifically called out some conservatism in your guide from the potential impact of tariffs. Curious if you could quantify the assumptions here in a little more detail. Maybe talk us through how you think about the balance in the back half of raising prices and the potential down tick in volumes as a result?

A - Craig Menear {BIO 15126612 <GO>}

Yeah. I mean, the uncertainty is what the total impact on the customer is economically overall. When we look at it specifically as it relates to Home Depot. If you think of China tariffs list one to four, four being at 10%, that's about a $2 billion or 2% of sales kind of cost impact. And so the way you have to think about tariffs is there's really two sites that you work on this. There is the actual cost side and there is a number of initiatives underway there. And then there is the potential of the impact to the customers that relates to the project.

And I can -- I'll let Ted, talk about the cost side. Then we have a number of initiatives underway as it relates to how we flow things through to the customer. We use our portfolio approach. We think about this business as a project business, which it is. And there is clearly ups and downs in elasticity, but we have pretty good tools for the merchants to use on that and we've actually been able to cover the top line. But Ted, if you want to talk about the cost side.

A - Ted Decker {BIO 16614891 <GO>}

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Yeah. I'd say, on the cost side, I couldn't be happier with our partnership with finance team, the accounting team, our assortment planning team. We have data of country of origin and potential tariff impact literally down to skew. So we know exactly, what are on the various list, when the tariff impacts will hit. We even know that through our retail accounting into when the impacts hit in our P&L. So thank you very much to the great partnership with the finance team.

As Craig said, on a macro perspective, through Phase 4 only being at 10%. It's a potential impact of about 2% of our US sales. Now with a number of activities that we're working with the merchants between negotiations, with our supplier base taking into account things like currency, transfer pricing in the United States, value engineering we're embarking upon with our suppliers with customer backed research if you have marginal dollar to put into the product, where you put it, the best customer value. And then, we're starting to see significant supply chain.

I would say, on the margin, I'm not aware of a single supplier who is not moving some form of manufacturing outside of China. So we have suppliers moving production to Taiwan, to Vietnam, to Thailand, Indonesia and even back into the United States. So when you net all of that out, we see this 2%-ish impact being much, much less call it something like 1%. And then, as Craig said, it's up to the merchant team to work with our overall portfolio approach to the business and project approach to the business to see how best if at all, there we pass on any of those net impacts to our customers.

Q - Zach Fadem {BIO 18911015 <GO>}

Got it. And then on the paint category, seems to have gotten a little more promotional so far this year. Could we talk through some of the dynamics here. What do you think is driven the elevated activity more so overall demand or weather environment? And maybe also talk through your process when deciding how you respond when you typically see changes out there in the pricing environment?

A - Ted Decker {BIO 16614891 <GO>}

So, I first -- I'd answer with exterior stains. So Behr is -- the weather improved and we did the reset quickly last year and much more comprehensively this year again with the number one and number two rated exterior stain with PPG product. We saw a great performance in our exterior stains business. On interior paint, interior paint has gotten more promotional in the marketplace. We have folks out there advertising in print, on media as much as 40% off. At Home Depot, we have, as was just released with the third-party agencies. We have the absolute best paint in the marketplace. Behr paint holds the top three slots and it's ratings again two different surveys.

And we are not going to fall into a high-low promotional trap, when we have the best product at the best everyday value. And as you know in the finance community, just speaking of promotional cadence, I can remember there was a lot of talk about breaking the buck in the money market world. And we have had a 3 times a year promotional cadence in paint of $10 off a gallon and $40 off 5 gallons in the major holidays of the year. Well some of our competitors chose to break the buck and we're not going to do that.

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Q - Zach Fadem {BIO 18911015 <GO>}

Got it. Appreciate the color and best of luck to you. Carol. Thanks again.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Operator

Our next question comes from the line of Karen Short with Barclays. Please proceed with your question.

Q - Karen Short {BIO 20587902 <GO>}

Hi. Thanks for taking my question. I just -- question on tariffs in general. So , I think last quarter you commented that on price -- raising prices as it relates to tariffs impacted pricing, you initially had negative units on appliances and then demand picked up a bit. Maybe a little color on what you're seeing in terms of the consumer reaction to higher price points? And then I just had a clarification question on the gross margin.

A - Craig Menear {BIO 15126612 <GO>}

Yeah. It's -- as we -- as I mentioned, we have a number of models that we're working right now. And it varies by category, there is elasticity variance by category. And that changes over time as well, but in the work that we've done, we've been able to actually cover the total top line sales in the models that we have out there. And when you think about laundry, because we have referenced that from the past. As time has gone by laundry was actually our highest unit comping category in appliances last quarter.

Q - Karen Short {BIO 20587902 <GO>}

Okay. That's helpful. And then on the gross margin front, I mean obviously lumber would have been a benefit to the gross margin this quarter. Could you quantify that and then help -- walk us through how lumber may impact gross margin in the second half?

A - Carol B. Tome {BIO 1907475 <GO>}

I'm happy to. With a lower penetration of lumber in the second quarter, it gave us 15 basis points of margin expansion. But that was absorbed by growth in lower margin categories like appliances, as well as portable power. We love our portable power sales, but we don't make a lot of money on it. So as we...

A - Ted Decker {BIO 16614891 <GO>}

I think it started to recovery in general.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you. Yeah. Absolutely, Ted. Thank you for that. So as we look to the back half of the year, we would expect lumber to stay down as we've talked about, not as much, as we saw in the first half but down, which will give us some benefits for the back half as well as for the year.

Q - Karen Short {BIO 20587902 <GO>}

Thanks.

Operator

Our next question comes from Steve Forbes with Guggenheim. Please proceed with your question.

Q - Steve Forbes {BIO 20413212 <GO>}

Good morning. I wanted to revisit the tool rental business and really whether you expect the B2B website experience to augment this initiative. And as I sort of think about it, maybe you could just expand on how you view the interplay between those two initiatives and the potential impact to Pro engagement trends. You mentioned sort of positive, but can you provide some additional color?

A - Craig Menear {BIO 15126612 <GO>}

So I'd say, first comment I'd make, I'll turn it over to Ann, is right now our initiatives aren't around necessarily connecting the B2B website to that from a digital experience that will come at later date. This is all about the investments that we're making right now in the physical locations.

A - Ann-Marie Campbell {BIO 16330617 <GO>}

Yeah. And just to support Craig on that, number one, the first thing we're doing is investing capital in the business. To your point, there is when we invest in fleet, we are able to drive more engagements with the Pro because we have product available. So that's the first thing we're doing is, making sure that we have the right assortment for Pro. Number two thing, we are doing there as well to drive the experience. We have had just tremendous success with the labor model we introduced in the the stores last year and was able to drive higher level of engagement by having our associates at the right time to engage our customer and so we're going to continue to lean into that.

And within the tool rental area, we are also making sure that we are addressing our labor model to ensure as well that we are having a high level of engagement as well there. And then, last but not least, as we think about how do we ensure that we expand our offering and we are able to push into areas at this point to delivery service and so forth. We are exploring hub locations for tool rental as well. So we're going to continue to push there. We are seeing tremendous growth. We are seeing higher levels of engagement and we believe as we continue to expand it will certainly be a complement for Pros and drive loyalty within the Home Depot.

Q - Steve Forbes {BIO 20413212 <GO>}

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Thank you. And then just a quick follow-up, maybe just a modeling question here, right? You called out the strategic investment dollar impact for the quarter and year-to-date. But are you still on track to expense -- I think it was $550 million for D&A for the year. Maybe just give us an update on where you are and what the full year outlook incorporates.

A - Carol B. Tome {BIO 1907475 <GO>}

Yes. We are on our plan with regard to both the expense and capital in support of our strategic investments.

Q - Steve Forbes {BIO 20413212 <GO>}

Perfect. Thank you.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Operator

Our next question comes from the line of Seth Sigman with Credit Suisse. Please proceed with your question.

Q - Seth Sigman {BIO 17751557 <GO>}

Hey, guys. Thanks for taking the question and Carol, all the best to you. I wanted to follow up on deflation. You discussed the lumber impact, I'm just curious about net deflation, if there were any positive commodity price movements, and I guess just how are you thinking about that as part of the new full year comp guidance?

A - Carol B. Tome {BIO 1907475 <GO>}

So lumber deflation, I said, was 110 basis points and then we had another 10 basis points of inflation, if you will, from the other commodities and categories that we call out from time to time.

Q - Seth Sigman {BIO 17751557 <GO>}

Got it. Okay. And then ex the deflation, your average ticket actually accelerated in the quarter versus last quarter, so I guess, outside of commodities, how do we think about the average price increase that you're seeing across the store. I guess on a same SKU basis? And then tying it in with the gross margin to the extent that you are seeing higher retail prices. Is that a benefit to the gross margin initially, until the higher cost actually start to flow through COGS, like, how do we think about that? Thanks.

A - Craig Menear {BIO 15126612 <GO>}

So on the price side, I'll let Ted give details. The innovation that comes into assortment certainly has a positive impact overall on our business as it relates to the ticket.

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A - Ted Decker {BIO 16614891 <GO>}

Yeah. I would say from a -- taking aside lumber and tariffs, from a pure commodity standpoint, we had quite a bit of pressure back half of last year, first part of this year that subsided so commodity prices generally versus a year ago, when you think of steel and resin, base metals, etc., are actually down. So that pressure on the outfit has subsided. To Craig's point, most of our pricing increases are mix driven in the sense that customers are trading up more innovative higher priced goods. We break out the components of our average unit retail increase, which has increased by far the largest driver of that in Q2, as well as the past several quarters is from new product introductions. which are higher price points because of innovation, think of cordless lawnmowers versus push gas mowers. On tariffs, we have a number of tests going on across the country, nothing of any sort of magnitude to say this we're taking price broadly at this point because of tariffs. But we are testing a number of things (Technical Difficulty)

A - Craig Menear {BIO 15126612 <GO>}

And to your question that its impact to margin, is we sell more innovative product and the customer steps themselves off that line structure it drives a higher gross margin dollar. It may not change rate, but it drives a higher gross margin dollar which is, what the most important thing is.

A - Carol B. Tome {BIO 1907475 <GO>}

And we're probably not giving you information that maybe you wanted. But I think it's an interesting statistics to look at the acceleration in our big ticket. This has been an underlying sign of health in the business. This is unadjusted, big ticket grew 1.5% in May, 4.1% in June and 5.3% in July.

Q - Seth Sigman {BIO 17751557 <GO>}

Okay. Thank you for the color. Appreciate it.

A - Isabel Janci {BIO 20990226 <GO>}

And Christine, we have time for one more question.

Operator

Thank you. Our final question will come from the line of Greg Melich with Evercore. Please proceed with your question.

Q - Greg Melich {BIO 1507344 <GO>}

I made it in. So Carol, thank you. Really, really helped through all the years, and (inaudible) all the break you get. We'll continue to annoy you as best we can. The -- I had a follow-up on tariffs and inflation, and then also digital. If that description you gave before of list one to four, does that assume a 10% tariff on everything or 25%, or is it 25% on lists one to three, and then the potential of 10 on list four?

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A - Craig Menear {BIO 15126612 <GO>}

Yeah. That's exactly, right. It's the 25 of one to three and then 10 on four.

Q - Greg Melich {BIO 1507344 <GO>}

Perfect. And so to tie into that, is that a reason why inventories might have been up 5% year-over-year a contributing factor.

A - Craig Menear {BIO 15126612 <GO>}

Yeah. Our inventory is all about the investments that we're making in the accelerated resets for the large part, so it has nothing going to do with that.

Q - Greg Melich {BIO 1507344 <GO>}

Got it. And then last on digital I know up 20%, continues to grow nicely, is that around 9% of sales. And it did decelerate, so I'm wondering did Amazon's move to next day. Did you see any impact on that? And do you think that was a factor in the deceleration, or is there something else going on?

A - Craig Menear {BIO 15126612 <GO>}

Yeah. We actually we're very pleased with our growth is 8.9% penetration in the quarter, up from 7.5% a year ago. And we've actually accelerated our capabilities in same day delivery. Mark, I don't know, if you want to share the details on that.

A - Mark Holifield {BIO 5952851 <GO>}

Yeah. As was noted earlier, we have expanded our next day parcel coverage, we're over 50% of the population now in next day parcel coverage. We've expanded our car delivery also to a greater than 50% out of our stores. So we're pleased with the time, we're taking out of our lead-time to customer. We continue to take lead time out with every move we make in the supply chain and each time we do it improves conversion.

A - Carol B. Tome {BIO 1907475 <GO>}

Just on the point on deceleration, it's a fiscal calendar shift, right . So that's on a comp number, that's a growth number.

Q - Greg Melich {BIO 1507344 <GO>}

Got it. That's great. Well, good luck, everybody, and thanks again, Carol.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

A - Craig Menear {BIO 15126612 <GO>}

Thank you.

Operator

Ms. Janci, we have reached the end of the question-and-answer session. I would now like to turn the floor back over to you for closing comments.

A - Isabel Janci {BIO 20990226 <GO>}

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

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.

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