# Best Buy Co., Inc. (BBY) CEO Corie Barry on Q2 2020 Results - Earnings Call Transcript

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FQ2: 08-29-19 Earnings Summary

*Press Release* *10-Q*

EPS of $1.08 beats by $0.09 | Revenue of $9.54B (1.67% Y/Y) misses by $-15.35M

## Earning Call Audio

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Best Buy Co., Inc. (NYSE:BBY) Q2 2020 Results Conference Call August 29, 2019 8:00 AM ET

**Company Participants**

Mollie O'Brien - VP, IR

Corie Barry - CEO

Matt Bilunas - CFO

Mike Mohan - President and COO

**Conference Call Participants**

Kate McShane - Goldman Sachs

Peter Keith - Piper Jaffray

Chris Horvers - JPMorgan

Anthony Chukumba - Loop Capital Markets

Michael Lasser - UBS

Ray Stochel - Consumers Edge Research

Steven Forbes - Guggenheim Securities

Curtis Nagle - Bank of America Merrill Lynch

Simeon Gutman - Morgan Stanley

Brian Nagel - Oppenheimer

**Operator**

Ladies and gentlemen, thank you for standing by. Welcome to Best Buy's Second Quarter Fiscal Year 2020 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. [Operator Instructions] As a reminder, this call is being recorded for playback and will be available by approximately 01:00 p.m. Eastern Time today. [Operator Instructions]

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

**Mollie O'Brien**

Thank you, and good morning, everyone.

Joining me on the call today are Corie Barry, our CEO; Matt Bilunas, our CFO; and Mike Mohan, our President and COO. During the call today, we will be discussing both GAAP and non-GAAP financial measures. A reconciliation of these non-GAAP financial measures to the most directly comparable GAAP financial measures and an explanation of why these non-GAAP financial measures are useful can be found in this morning's earnings release, which is available on our website investors.bestbuy.com.

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

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

I will now turn the call over to Corie.

**Corie Barry**

Good morning, everyone, and thank you for joining us.

Today, we reported $9.54 billion in revenue, expanded our non-GAAP operating income rate by 20 basis points, and delivered non-GAAP diluted earnings per share of $1.08, which was up 19% compared to the second quarter of last year. Our comparable sales growth of 1.6% was on top of a very strong 6.2% last year and within our guidance range for the quarter. The international segment comparable sales declined 1.9%, driven primarily by continued soft macroeconomic conditions in Canada.

Our domestic segment comparable sales were up 1.9% as we continue to drive the customer experience across online, stores and home. From a product category standpoint, the comparable sales were buoyed by strength in appliances, tablets and headphones, personally offset by declines in gaming and home theater.

The Q2 profitability was better than expected, primarily driven by strong expense management. This points to the culture we have built around driving cost reduction and efficiencies to help fund investments and offset pressures.

Before, I talk about the progress we have made on our Building the New Blue strategy and our continued excitement about our strategic opportunities, I would like to address the latest development on the topic of tariff. As you know, since our last earnings call, the administration finalized the products on List 4 and the timing of their implementation. We were a very active participant in the official comment process, and we are pleased, the administration decided to delay the effective date of many of the products on the List until December 15th. We believe this will mitigate some of the impact of higher prices for American consumers during the holiday season. So, List 4 tariffs are at a 15% level and have two effective dates.

The first effective date is September 1st, and the most notable affected categories relative to Best Buy are televisions, smart watches and headphones. The second effective date is December 15th and the most notable categories relative to Best Buy are computing, mobile phones and gaming consoles.

Given the trends, many of our vendors are in the process of migrating their manufacturing out of China. Our merchants are also addressing this new contest, with a view to minimize costs and risks while continuing to offer exciting technology products and solutions to our customers. As a result, while there will be some short-term volatility, we expect to adapt to this new environment.

Let me say a few words about the updated annual fiscal ‘20 guidance we are providing today, and that Matt will expand on later in the call. On the topline, we narrowed the revenue range; on bottom-line, we are raising our non-GAAP EPS guidance range. This reflects the continued momentum of our strategic initiatives. It also includes our best estimate of the impact from the List 4 tariffs and the most recent announcement regarding List 3 moving to a 30% rate, net of the actions we are taking to mitigate their impact, including bringing in products ahead of the tariff implementation, decisions around vendor and SKU assortment, promotional and pricing strategies, sourcing changes and other strategies employed in partnership with our vendors.

As others have noted, it is difficult to factor in the uncertainty related to overall customer buying behavior. It is hard to predict how at the macro level consumers will react to higher prices resulting from tariffs. As you would imagine, the general overall volatility in the financial markets adds a level of caution to our outlook.

This is a rapidly evolving situation and our teams are doing an excellent job adapting on a daily basis. As we have said before, we are supportive of free and fair trade between the U.S. and China, and appreciate the delay on many products. And we're actively engaged in mitigation efforts to minimize the impact on consumers and our business.

The tariffs do not change our excitement about our strategic opportunities, however. And I would now like to talk about the progress we are making on our Building the New Blue strategy. An example of our growing commitment to health, during Q2, we launched a new collection of connected fitness products from some of the world's most innovative exercise companies, including Hydrow, ProForm, Hyperice and NordicTrack. This new assortment includes a range of connected bikes and rowing machines and recovery system loved by many pro athletes. The collection is available now on bestbuy.com with a new dedicated fitness space coming to more than 100 stores by the end of the year. Our store employees and In-Home Advisors will receive special training to help customers discover, understand and purchase the equipment, whether in a store or in their home. And Best Buy and Geek Squad will manage delivery and installation.

Meanwhile, we continue to make progress both in terms of scaling the GreatCall consumer devices and services, and advancing our commercial monitoring service with a focus on aging seniors.

Last quarter, we updated you on our acquisition of a senior focused health services company called Critical Signal Technologies or CST, to help more quickly scale the commercial monitoring business. Earlier this month, we acquired the predictive healthcare technology business of BioSensics, including the hiring of the Company's data science and engineering team based in Watertown, Massachusetts. These talented employees drive innovation through wearable sensor technology that addresses some of the biggest challenges faced by the aging population, such as falls. These tuck-in acquisitions together with GreatCall, complement our existing capabilities like Geek Squad and In-Home Advisors to better help seniors live longer in their homes, help reduce their healthcare costs, and bring greater peace of mind for their families and caregivers. We look forward to spending more time on our health strategy at our Investor update next month.

Speaking of Geek Squad, during Q2, we continued to expand our Total Tech Support program, which provides members unlimited Geek Squad support for all their technology, no matter where or when they bought it. We grew the member base at a steady rate while executing on our roadmap to continually improve the customer experience.

Additionally, Best Buy is now fully certified chain-wide as an Apple authorized service provider, becoming the nation's largest physical destination for Apple authorized repair services, including same day iPhone repairs. Nearly 10,000 of our Geek Squad agents have completed training for all Apple device repairs. And all of our nearly 1,000 stores are equipped with Apple authorized repair tools and parts. As you would imagine, consumers can schedule their repair by going to bestbuy.com, but what you might not know is that they can also go to Apple's own website to schedule a repair at Best Buy.

More than 200 Best Buy stores across the U.S. have been Apple authorized service providers since 2017 and have enjoyed strong customer satisfaction scores. So, we are pleased to expand that partnership with Apple to provide even more consumers with convenient access to safe and reliable repairs. And it drives traffic. Almost 40% of these Apple repair customers are either new to Best Buy or reengaged Best Buy customers. This is another great example of something we can do with our vendor partners that others cannot.

In addition to tech services, we provide our customers with a number of financing options that help them acquire the products they need and also create stickiness over time with our brand. For example, sales transacted on our Best Buy credit card were 25% of total sales last year, and that number is growing. We always offer customers our branded credit card first. However, there are people who may not be interested in getting a credit card or are unable to qualify for it because of low credit scores, or in many cases, simply no credit history. And that's where our new lease-to-own program comes in.

Throughout the second quarter, we continued to see customers use lease-to-own to acquire products across a wide variety of categories, with the largest being computing. We also continued to see a significant number of customers take advantage of the 90-day purchase option, which consists of an additional payment plus the retail price.

Later this quarter, we expect to launch lease-to-own in nine more states, including California and New York, which will complete our full 45-state rollout. We believe that this program will build over time as our associates continue to get up to speed on the offer, consumer awareness if it grows and as we enhance the customer experience, both in our stores and online.

As we continue to implement these important customer-facing initiatives, we’re also taking steps to evolve our retail model. In Q2, we made strategic changes to our field operations, to accelerate growth, and to create a more seamless customer experience across all channels. We did this because we know that customers interact with us across all channels, but at times, it can be confusing or repetitive for them to navigate Best Buy as we were organized.

At the same time, as we look at our penetration by geographic market, we see that it varies wildly, yet our tools and structure have been one size fits all for our local markets. So, we have reengineered retail in a way that puts the customer at the center and empowers the local leaders to serve their customers in ways that best suit them and take advantage of local opportunities. We have put single leaders in a position to be accountable for stores, services, supply chain and home propositions in their market.

We believe these changes will simplify processes and allow us to seize growth opportunities within individual markets. It will also create an environment for our employees to grow and allow our teams to collaborate more effectively and efficiently in service of our customers.

One of the opportunities we continue to be the most excited about is home where we continue to increase the number of In-Home Advisors to meet consumer demand, and expect to be at around 700 advisors at year-end.

With the changes we made to our operating model, there is more local leadership support to deepen the advisors development, customer expertise and performance. And we are focused on a seamless customer experience in the home, no matter how it’s delivered.

We also continue to focus on developing digital innovation and marketing strategies to drive engagement with our customers. For example, for back-to-school, we are integrating influencers and YouTube into our advertising in an interactive way. Also this year, we have increased our use of digital videos that feature real life Best Buy associates, providing authentic tech insights. These videos celebrate the passion, expertise and knowledge of our people, highlighting the role they play as inspiring friends for our customers. This is driving increased trust among viewers, and the highest unique viewers and watch times we've seen across our YouTube channel.

From a digital innovation standpoint, starting with the Samsung Note 10 launch, bestbuy.com launched the ability for customers to trade in their old phone to purchase a new one, something that was previously only available in physical stores. Since we have expanded this to a multichannel capability, a customer can put the full traded value of their previous phone towards the purchase of a new device instantly, thus improving the customer experience regardless of the channel.

To improve the home theater shopping experience in the app, we launched augmented reality capabilities that can help customers select the right TV. This new capability allows customers to place three dimensional virtual TVs that are correctly scaled to size on a wall or table. This feature is driving higher customer confidence in choosing the right screen size and as a result, higher conversion, and we expect to also reduce returns. Supply chain is also an area where we have strong momentum. Since our last earnings call, we have automated three additional distribution centers across the country. And we will go live with another automated facility prior to the holiday season.

We also relocated one of our local distribution centers to a larger facility to support our growth in major appliances. These changes support our strategy to offer enhanced speed of delivery to customers. As we have shared previously, we offer same-day delivery on thousands of items in 40 metro areas. And while same-day delivery is an important offer, we have found that our customers really value two things: They want free delivery and many want to be able to get it the next day.

We offer next day delivery for thousands of products in 64 metro areas that reach 80% of Best Buy customers. This is free for orders over $35 and does not require a membership fee. Of course, you all know that we also provide our customers the extremely convenient option to pick up their products at one of our nearly 1,000 stores. What you may not realize is that we promise their items to be ready within one hour of placing their order and on average, those orders are ready within just 40 minutes. We also continue to drive efficiencies and reduce costs in order to fund investments and help offset pressures.

During the second quarter, we achieved $155 million in annualized cost reductions and efficiencies, bringing the cumulative total to $730 million since Q2 fiscal 2018. This is toward our fiscal 2021 goal of $600 million. So, we've not only exceeded our goal, we did it over a year early. We have now successfully delivered on three considerable cost reduction targets in the last seven years, totaling more than $2 billion. We plan to provide a new long-term cost reduction and efficiency target at our Investor Update next month.

In summary, we are pleased to report strong results for the first half of the year. And we're excited about the long-term opportunities ahead of us as we continue to make great progress on our Building the New Blue strategy. I want to thank our associates across the Company for their hard work and dedication every day to help deliver on our purpose to enrich lives through technology.

At Best Buy, we strive to be a purposeful, value-driven human organization. With that in mind, we are very proud of the recognition we have received in recent months for being a top employer. We ranked number seven on Forbes list of America's best employers for women and for the first time earned a spot on the Indeed's list of the 50 top-rated workplaces. We were also named a best place to work for disability inclusion. And we are changing the world together as noted by Fortune magazine, which recently included us on its Change the World List. This list recognizes companies for using their business strategy and operations to make a positive human, social or environmental impact. All of these awards underscore our mission, which is to build a purposeful company that does good things for the world and great things for all our stakeholders.

Now, before I turn the call over to him, I would first like to say a few words about our new CFO, Matt Bilunas. For obvious reasons, the search for a new CFO was a personal one. First, I was picking the person to take my old job and run a functioning and team I know and love. And second, any CEO will tell you that a strong finance partner is critical to their personal success and the success of the Company they lead. I worked closely with Matt for more than a decade. I trust him and I'm completely confident that his experience, skills and commitment to the Company's continued growth make him the perfect choice for this role.

I will now turn the call over to Matt.

**Matt Bilunas**

Thanks, Corie. Good morning, and hello, everyone.

It's a huge honor to be given the opportunity to help lead this Company forward as CFO. We have made tremendous progress in how we enrich people's lives through technology, and I am confident we will continue to build even deeper relationships with our customers as we serve them online, in stores and in their homes.

During my 13 years at Best Buy, I've had the benefit of being in the field, working with the international team, and leading financial planning and analysis teams during the turnaround effort. Now, I'm excited to lead our world class finance organization, which has been instrumental to our success here at Best Buy.

Now, on to Q2 financial details. Let me begin by talking about our results versus expectations we shared with you last quarter. On enterprise revenue of $9.54 billion, we delivered non-GAAP diluted earnings per share of $1.08. EPS results exceeded our expectations and our revenue performance was near the midpoint of our guidance range. Our operating income rate exceeded our expectations, primarily due to strong expense management. A lower effective tax rate also provided a benefit of approximately $0.02 versus our earnings per share guidance.

I will now talk about our second quarter results versus last year. Enterprise revenue increased 1.7% to $9.54 billion, primarily due to the comparable sales increase of 1.6%. Enterprise non-GAAP diluted EPS increased $0.17, or 19% to $1.08. This increase was driven by one, increased operating income dollars from both the higher operating income rate and higher revenue; two, a $0.05 per share benefit from the net share count change; and three, a $0.04 per share benefit from a lower effective tax rate.

In our domestic segment, revenue increased 2.1% to $8.82 billion. This increase was driven by a comparable sales increase of 1.9% and revenue from GreatCall, which was acquired in October 2018, partially offset by the loss of revenue from 13 format store closure -- large format store closures in the past year.

From a merchandising perspective, the largest comparable sales growth drivers were appliances, which includes both majors and small appliances, tablets and headphones. These drivers were partially offset by declines in our gaming and home theater categories.

In addition, comparable sales in the services category increased 10.7% versus last year. Part of the growth was due to the refinement of revenue recognition for our Total Tech Support offer. In Q4 fiscal 2019, we refined the revenue recognition for a Total Tech Support offer because we had sufficient history of member utilization to move from recognizing revenue on a straight line basis over the membership contract to recognizing revenue on a usage basis, therefore better matching the fulfillment costs with revenue.

This results in more of the annual fee being recognized upfront as the customer usage of the program is heaviest when they first become members. This refinement of revenue recognition impacts new contracts created since the start of our fiscal 2019 fourth quarter on a prospective basis.

Domestic online revenue of $1.42 billion was 16.1% of domestic revenue, up from 14% last year. On a comparable basis, our online revenue increased 17.3% on top of 10.1% growth in the second quarter of last year, which was primarily driven by higher average order values and increased traffic.

In our international segment, revenue decreased 3.4% to $715 million. This was primarily driven by a comparable sales decline of 1.9% and approximately 120 basis points of negative foreign currency impact. The comparable sales decline was driven by Canada and was partially offset by comparable sales in Mexico.

Turning now to gross profit. The enterprise gross profit rate increased 10 basis points to 23.9%. The domestic gross profit rate was 24% versus 23.8% last year. The 20 basis-point increase was primarily driven by the impact of GreatCall's higher gross profit rate, which was partially offset by higher supply chain costs.

International non-GAAP gross profit rate increased 70 basis points to 23.8%, primarily due to a higher year-over-year gross profit rate in Canada, which was driven by higher margin from the services category.

Now, turning to SG&A. Enterprise non-GAAP SG&A was $1.9 billion, or 19.9% of revenue, which increased $24 million and decreased 10 basis points to last year as a percentage of revenue. Domestic non-GAAP SG&A was $1.74 billion or 19.7% of revenue versus 19.8% of revenue last year.

SG&A dollars increased $23 million due to GreatCall's operating expenses and higher advertising expense, which was partially offset by lower incentive compensation expense versus last year.

International SG&A was $166 million, or 23.2% of revenue versus $165 million or 22.3% of revenue last year. The $1 million increase included an impairment charge for discontinued technology in Canada, which was partially offset by the favorable impact of foreign exchange rates.

During the quarter, we recorded $48 million of restructuring charges, the majority of which was driven by a retail operating model change as Corie mentioned earlier. On a non-GAAP basis, the effective tax rate of 22.8%, compared to 25.4% last year. The favorability versus last year was primarily driven by a larger tax benefit related to stock-based compensation and a favorable resolution of certain tax matters.

During the quarter, we completed the acquisition of CST, which was funded with approximately $125 million of existing cash. The acquisition of CST is not expected to have a material impact on our revenue or non-GAAP operating income this fiscal year.

We returned a total of $363 million to shareholders through share repurchases of $230 million and dividends of $133 million. Our regular quarterly dividend of $0.50 per share was an increase of 11% compared to prior year. As we previously announced, we still intend to spend between $750 million and $1 billion on share repurchases in fiscal 2020. Finally, we now expect the capital expenditures for the year to be in the range of $750 million to $800 million.

Lastly, I will discuss our outlook. Our outlook reflects the strong earnings performance in the first half of the year, as well as our best estimate of the tariff impacts and consumer buying behaviors in a very fluid environment.

To be clear, the guidance we are providing today incorporates the estimated impact of the List 4 tariffs that Corie described and also includes our assumptions related to List 3 moving from a 25% to a 30% tariff rate. Specifically, for the full year, we now expect enterprise revenue in the range of $43.1 billion to $43.6 billion and enterprise comparable sales growth of 0.7% to 1.7%.

As a reminder, this top-line growth expectation is on top of the best two-year stack in 14 years and reflects factor such as the anticipated cyclical slowdown of the traditional console gaming category and the continued maturation of the mobile phone category. We expect our enterprise non-GAAP operating income rate to be flat to slightly up to fiscal 2019's rate of 4.6%, reflecting our continued focus on balancing investments in our strategy, pressures in the business and efficiencies.

We expect our non-GAAP effective income tax rate to be approximately 24% and our non-GAAP diluted EPS to be in the range with the $5.60 to $5.75, which compares to our previous guidance $5.45 to $5.65.

I would like to share a few of the assumptions reflected in our annual guidance. Consistent with the outlook we provided at the beginning of the year, we expect both gross profit and SG&A dollars to be approximately flat to last year as a percentage of revenue for the full year. As a reminder, we have also shared there would be variations between the quarters.

Our guidance today implies a higher year-over-year operating income rate in Q3 and a lower operating income rate in Q4. A lower year-over-year operating rate in Q4 was assumed in the original guidance we provided at the start of the year and now also includes the tariff changes we have discussed today.

For the third quarter specifically, we are expecting the following: Enterprise revenue in the range of $9.65 billion to $9.75 billion; enterprise comparable sales growth of 0.5% to 1.5%; non-GAAP diluted EPS of $1 to $1.05; non-GAAP effective income tax rate of approximately 26.5%l and the diluted weighted average share count of approximately 267 million shares.

I would like to provide additional items of color for Q3. We expect our Q3 gross profit rate to expand versus last year. We expect the gross profit rate expansion to be higher than the year-over-year increase we reported in Q2. We also expect our SG&A dollars to grow as a percentage in the very low single digits. At this time, we do not expect the recent tariff announcements to have much of an impact on our Q3 performance.

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

**Question-and-Answer Session**

**Operator**

Thank you. [Operator instructions] Our first question today comes from Katie McShane of Goldman Sachs. Please go ahead.

**Kate McShane**

Hi. Good morning. Thanks for taking my question, and congratulations, Corie and Matt. I wanted just to ask about the supply chain costs that were noted in the gross margin discussion. Could you go into any more detail about what drove that during the quarter?

**Corie Barry**

Yes. So, there's a couple of things that sit under that. And they've been pretty consistent quarter-to-quarter. First, the first piece that is just overarchingly a little bit more spend, especially when it comes to some of our large cube and the growth that we've seen, frankly, online where we've been investing in speed. The second part of that is more the strategic side of the investments that we started talking about at our Investor Day two years ago. And we've been putting some capital into, especially as it relates to things we talked about today, around automating some of those metro ecommerce centers, and around investing in some of the incremental facilities that we need in order to support the large cube growth that we've seen. So, you've got a little bit of both things, both just systemically the higher volumes, and then secondarily, the more strategic investments, hence the reason we talked about those continuing throughout the rest of the year here.

**Kate McShane**

Okay, great. And if I could just ask one follow-up about your guidance and the narrowing of the range on the top line. Could you talk about what's a little bit better than expected on the low end of that, and is the lowering of the top line exclusively tariff related?

**Matt Bilunas**

Yes. Thanks for the question. So, for guidance purposes, I think what we're looking at for the rest of this year, one of the things that sequentially changes from the first part this year is a little bit more of a drag from the gaming category that we saw in the first part of the year. So, gaming was quite bit stronger in Q3 and Q4 of last year. And so, we are seeing a bit of -- a bit more weighted impact from that business being expected to be down a little bit more in the back half of this year. That's the biggest sequential probably change going forward as we look towards the back half of the year.

**Corie Barry**

And to answer the other part of your question, Kate. The tariff impact is built in there; it is not exclusively related to the tariff impact. This is just taking into account some of the trends that Matt's talking about as well as some of our estimates around the impact of tariff.

**Operator**

Our next question comes from Peter Keith of Piper Jaffray. Please go ahead.

**Peter Keith**

I did want to follow up on the tariff question. So, you provided a lot of good detail. But, I guess, I wanted to understand the approach that you're thinking about for pricing, because presumably, there may not be that many price increases in calendar year '19, but there could be a lot more to come in 2020. So, maybe strategically, do you think that a fair share of items will see price increases? And how do you think about the sort of the portfolio approach to managing through that?

**Corie Barry**

Yes. This is the most difficult place for us to make projections. I think, you understand better than anyone, and there's a bit of art and a bit of science to estimating this. And we don't exactly have a precedence for the quantity of moving pieces that we have in place right now. There's a few things we're trying to take into account here. So, first, you know this is -- there's a lot of changes still going on in terms of what exactly is on the List, when they're implemented and at what rate. And there's even some public comments around potentially some vendors being exempted. And so, we're watching that but there's a lot that's moving there.

Second, as we've already seen, we believe many vendors are going to continue to migrate their manufacturing out of China. And so, we think the total prospect of business that's impacted is going to be materially less, even just next year, because you're seeing those supply chains already start to move.

And then, third, the impacted -- what we think is really impacted in our business is actually substantially less than the overarching quantity that is affected by tariffs, meaning our teams are doing really excellent work. We talked about it in prepared remakes, with mitigating strategies to help offset some of the impacts here. And so, the piece that's impacted is actually substantially smaller than the overall affected quantity of SKUs. And so, we're working to understand what that looks like into next year. But, to get precise around exactly where it's going to result in price increases, where the promotional environment will land because we're only going to stay price competitive, and how that actually shows up next year, it's going to still take us some work from here.

**Peter Keith**

And then, separately, maybe looking out to next year and contemplating some near-term headwinds around gaming and mobile. I was hoping you could talk about some of the technology innovations that you see evolving over the next one to two years, and thinking specifically around 5G, 8K TVs, and potentially a new console cycle. If you have any thoughts on how that may impact your business?

**Mike Mohan**

Peter, it's Mike. Thanks for the question. It might be a little too early to give you specifics on those categories. But we're excited about all of them. And I think about what Corie talked about and how we've realigned our field structure to support our markets. And that gives us an opportunity, as technology needs to be either showcased in the store environment or actually in people's homes to leverage more resources and be able to have Best Buy partner with whomever it may be in this case with 5G; it's our carrier to show what the technology can do well beyond what it would do on a phone like it is today. We're quite excited about where the evolution in TVs is going because it plays into where Best Buy is historically done best showcasing technology and making sure we can get product to customers' homes. And while gaming is a drag this year, every time we've had a new console cycle, our ability to get products in consumers' hands in a way that matters to them and support them with solutions, and now in this case with Total Tech Support has us quite excited. But, we'll probably give a bit more color on those technologies as we get into our fiscal '21 guide.

**Operator**

Our next question comes from Chris Horvers of JPMorgan. Please go ahead.

**Chris Horvers**

So, I wanted to follow up on the guidance question a little bit more. So, just to think about it, you beat about $0.27 year-to-date, guided up 3Q about $0.08 and raised the year $0.10 to $0.15. So, it seems like you're lowering the fourth quarter, I guess implied versus the Street by $0.20 to $0.25. Is that accurate? And I know you talked about the gaming headwinds and the tariff. But, maybe you could talk, maybe break that down a little bit more. Was the gaming headwind that you're now assuming, presumably most acute to 4Q, sort of how much do you assume comp might benefit from an AUR perspective as prices go up? And then, on the margin line, gaming being worse, I would think would be better from a gross margin perspective. But, obviously you have the tariffs. So, I know, it's a very specific question, but really trying to understand how you thought about the fourth quarter update?

**Corie Barry**

Yes. I'll start, and then Matt can follow. What I'm saying, first of all, is, the general cadence of the year is flowing exactly how we expected it. And so, that's good. And I think your estimate on that 20% -- or $0.20 plus, taking it down is on the high side. Because we saw early in the year, there would be some pressure to Q4. Matt will go into that a little bit. But, what I think overarchingly, what I would say is, it's less of a takedown than that. And it's more of what we were talking about before, us just trying to do our best to estimate what we think -- with all the mitigation strategies, what we think some of the implications might be in Q4, which we said on the call is a bit of a moving target. Matt, maybe you can provide some more color on what we see going into the year.

**Matt Bilunas**

Absolutely. So, Q4 lower rate is largely being driven by number of items we contemplated in the original guidance. It's primarily result of lower gross profit rate, compared to last year. And there are a number of factors that are driving that. But first, it might be helpful to point out, for the last three quarters, we've been seeing some sources of expansion that will lap in Q4 this year. The first one is the revenue recognition refinement to Total Tech Support offer last Q4. That's been expanding our margins a little bit since Q4 last year.

The second is the acquisition of GreatCall, which we completed October last year, and we cycle that in Q4 of this year. So, that won't be a source of expansion. And on top of that, what we're seeing is slightly lower product margin rates in Q4. We're giving the teams a little bit of flexibility. It's important for them to have some to navigate through the holiday period. So, product rates are down a little bit in Q4. The second source of a little bit more pressure that we contemplated already was the services category. We're seeing -- we know we have a reduced profit share in Q4, because we had one last Q4. The other is in the area of supply, delivery and install where we're seeing a higher volume of large product that requires a little more install costs and delivery costs. And lastly, we knew that supply chain costs would continue to be a drag year-on-year in Q4. They're a little more of a drag in Q4 than they are going to be in Q3.

Again, all of those things were contemplated as we went into the guidance at the beginning of the year. The one thing we did add was the expectation of the tariff impact, which Corie mentioned. So, that would be the new thing that we put in. But, we knew most of that pressure was coming when we started the year.

**Chris Horvers**

And then, as a follow-up, the gross margin in Canada was very strong here in the third quarter, and presumably this is the maturation of the services model in that market, which I believe was ahead of the U.S. So, what does this tell us about the gross margin tailwinds that you might see as you get into 2020 in the domestic business, given that I think it is lagging from a rollout perspective?

**Corie Barry**

So, first, I want to reinforce what you said, which is definitely we're seeing Canada lap now a few years of having their version of what we call Total Tech Support. But their version is quite different. So, I want to be clear about that. They -- and we've talked about this before. They started with different models than we have. In their case, most often, it's an offer that includes a warranty proposition with it, but also has support across the business. It's offered a little bit differently by category. So, I wouldn't say exactly what they're seeing is going to be perfectly replicated in the U.S. because we're looking at more of a pure support offer. But, at the same, time, we like what we're seeing there. We're trying to learn from what they're doing in Canada, and at the same time, figure out what's right for our customers. Obviously, we're not dying next year yet. But, like we said in our prepared remarks, we're happy with the ramp in TTS. And the best news is our customers clearly value having support across their devices, whether they bought them from us or somewhere else. And so that frankly, and the stickiness of those customers is what's most important to us here in the U.S.

**Operator**

Our next question comes from Anthony Chukumba of Loop Capital Markets. Please go ahead.

**Anthony Chukumba**

Corie, you provided a little bit of color on rent-to-own including the fact it's going to be I guess rolled out to an additional nine states. Any color you can provide in terms of the comp lift from rent-to-own? I mean, was it material in the second quarter, and what are your expectations for that comp lift as the year progresses?

**Corie Barry**

Yes. So, what I'd start with is that we said it last time, we're going to consistently say it, this is a great offer. It's great for our brand. It's great for our customers. And I think we said it out on the prepared remarks, financing options for our customers is really important. 25% of the business is done on our own branded card. You can see that it's important to have options. We always start with the Best Buy credit card, but now we have something additional that is available to customers who either might not want that as an option, or might not qualify.

Lease-to-own is having a positive impact on our comps, but we're not going to show the exact details. And the reason is because this is a program we would expect to build over time. We're still really early in this one. I mean, we're only into the first quarter of having it rolled out into two thirds of our stores. Over time, we think our sales associates will get more and more comfortable with the offering for our customers. We think customer awareness will continue to increase. We need to continue to implement some experience improvements. And ideally, we want to make this available online next year, as well as obviously very important to have a digital offering.

And then, to your point, we still have nine states to go, two of those being California and New York, some big ones. So, like we expected, we're definitely still seeing a number of customers use this program who are either new to Best Buy or that we haven't seen for a while. And so, we continue to like that. We'll give a little bit more color on this one at the Investor Update next month. But, in general, we definitely like how it's ramping and piecing. And most importantly, it's something that our customers seem to like. And the feedback we get from our associates is also that it's really nice to have this as a secondary financing option.

**Operator**

Our next question comes from Michael Lasser of UBS. Please go ahead.

**Michael Lasser**

Presumably you had existing purchase orders in place for your holiday product prior to when these tariffs are going to come in and your vendors are the importer of record. So, are you going to be sharing in the actual tariff impact, given those dynamics? And if so, can you quantify what the price increase you -- contribution you've factored into your fourth quarter comp guidance? It looks like the domestic segment in the 1% to 2% range. And then, as part of that, how has the elasticity of the laundry equipment business that did see some tariffs earlier, informed your view on how this whole situation is going to unfold? Thank you very much.

**Mike Mohan**

Hey, Michael. It's Mike. I'll start and then maybe Corie can chime in. When I look at -- to answer to your first question, yes, with all of our vendors, we have existing purchase orders forecast commitments and contracts around what we pay for items and how we bring them into the country. To give you color on what might be changing, it will be far too soon to tell you that because some of the stuff's already been on the water, some of the stuff's actually in the U.S., some of the stuff may not have price increases, some of these items may evolve to different models before there's any really significant price impact, whether they get sourced from another factory outside of China, or really wrap to something else that's got a different feature set that would warrant a price increase. So, as we tried to explain in our prepared remarks, it's very, very fluid as to what we're doing.

The one thing I would probably leave you with on that point is the significance that Best Buy plays in the overall consumer electronics market worldwide, does give us more leverage than I think -- than we can probably explain on a call like this. But, it gives us exposure, because of where we source merchandise from, the ability to get to customers with the newest technology that create the right buying cycles is really important. And we're working with every one of our partners from where they source. Well, they're the importer of record, as you noted, to mitigate any impact to consumers on pricing and to us.

On a comment around appliances, there's very little to draw from that, and I'll let Corie add anything in between. Given we've been living with price increases from a variety of reasons for the last almost two years, that category is very driven to duress and replacement. And there's a different elasticity when you're not trying to drive demand for a natural purchase. So, we've got good understanding, but it doesn't apply a lot of go forward logic here. So, Corie?

**Corie Barry**

Yes. What's really tricky, and we started on it with the earlier question. I mean, we think that of our total cost of goods sold about 60% comes from China. But, it's a massively smaller portion of that that is actually, we think affected by the tariffs because of some of the negotiating power, because of the mitigating strategies that we're putting in place.

To your point about price elasticity, Q4 is also a really different quarter. I mean, keep in mind, this is a very promotional quarter and we will always be price competitive. So, the team is working through what stands from prior history of price elasticity, a little bit different in Q4. So, to Mike's point, we've got a team who's working with our vendors, doing a really excellent job with the various mitigating strategies that they have in place, and then frankly, positioning us for the holiday really well.

**Michael Lasser**

Thank you. My follow-up question is on the Progressive situation. It seemed like that's gaining a good amount of traction, given all the comments that you've made. Would your domestic comps have been positive without the Progressive relationship?

**Corie Barry**

We're not going to give the exact comps for Progressive, like we said before, and because mainly it's really early. We're still ramping. We're learning a lot. And ideally, over time, we continue to see better and better results from that.

**Operator**

Our next question comes from Ray Stochel of Consumers Edge Research.

**Ray Stochel**

How do you think about your TV assortment now versus prior years? A couple points on that would be different approaches your vendors are taking on smart TVs and as a result over the top services. And then, how do you think about your TV supply chain and product mix compared to others in terms of geographical sourcing around tariffs? Thanks.

**Mike Mohan**

Hey, Ray. It's Mike. Thanks for the question. I feel very good, to answer your question about our TV assortment, now versus prior years. Best Buy has a history of leading innovation in this space, whether it's the connectivity of the device, the technology in the screen, or what size the TV is, and those are the three factors, I think people are looking at the most.

Interestingly, as more people look for solutions with streaming services, I would hope you would see that by taking a leading role, helping explain what people can do that you didn't think was possible. And getting a unified experience across multiple steps in their homes or finding ways to perhaps save some money. And we're working on ideas that can take advantage of the fact that 25% of our customers use the Best Buy credit card, and how can you blend the fact that we can help making buying device easier, perhaps with what you want to do with it. So, I'll stop the comment with that there.

When I think about our TV supply chain, yes, TVs are impacted on List 4A. Those are specifically TVs that are sourced out of China. And so, just as a reminder for the group listening that a bulk of Best Buy's business is on the large screen size, and those TVs are sourced out of Mexico. And those products are primarily 55-inch and larger TV sets. And we feel very good about those and where they're positioned and our inventory levels and the prices and the promotions we build and run on those. And when it comes to the products that are sourced out of China with an advanced lead time, I also feel good about what we have currently in inventory. And we'll look at our assortment as we move forward, based on where the demand signals are, if there's any pricing implications to them.

**Operator**

Our next question comes from Steven Forbes of Guggenheim Securities. Please go ahead.

**Steven Forbes**

I wanted to start with a follow-up on the tightening of the full-year comp guidance and the commentary about the second half uncertainty. So, maybe if you can, just expand on what you're seeing today, right, as it relates to your consumers' conversion patterns, both in the store and online, inclusive of trade down or maybe just lower traffic conversion rates. I mean, are you seeing anything that gives you pause today or is it is it more just about conservatism, right, as we head into holiday here?

**Corie Barry**

No. I would definitely not characterize us seeing anything that gives concern today. I mean, I think we're very pleased with an almost 2 comp domestically here in Q2. We're seeing good buying behavior and I think we continue to see -- consumer is really interested in the products that we sell. And so, that gives us confidence heading into the back half here. We definitely tightened the range, because A, we've just made it through half the year, and the result are there for the first half of the year; and then B, we're doing our best to look at specific category that we've actually mentioned at the beginning of the year, like gaming or like the slowdown in mobile and just making sure that we feel like we take those into account. And then, finally, doing our best in a very fluid and changing environment to think through what we think the implications are in our categories in the back half.

**Steven Forbes**

And so, that's sort of a perfect segue into my follow-up here. You think about sort of your initial outlook for certain product category growth in 2020, whether it's an acceleration in certain categories, like gaming and mobile maybe even TVs. I mean, what categories did you -- sort of the greatest amount of pause as you conceptualize the potential demand implications of rising retail prices, given the likelihood that maybe underlying industry growth should be better next year as well?

**Mike Mohan**

Steve, it's Mike. Peter asked a pretty similar question around what we see for next year. The best way I'd characterize it is, there's a lot of technology that's on the forefront of becoming more mainstream for consumers with what we're seeing this year. 8K TV is a great example of the connectivity solutions with streaming. There is a couple of services that are going to go live later this year that will create excitement in this space. There's continued demand for people to want to stay connected. And I think this is the way we're building relationships and memberships around our Total Tech Support offer. But, put those all together, add them into things we're seeing with good tailwinds, like our appliance business, the places that we're competing very well. That's how I'd look at the landscape of categories right now. But again, it's too soon to give category specifics for our fiscal '21 guide.

**Operator**

Our next question comes from Curtis Nagle of Bank of America Merrill Lynch. Please go ahead.

**Curtis Nagle**

Maybe just a little more specificity, if you could on gaming and why you think, I guess, second half of the year might be a little bit tougher than you initially thought, if I understood your comments correctly.

**Matt Bilunas**

Yes. The gaming cycle is well known, and as the years progressed what we've seen is as there is more visibility to a couple of new platforms that have yet to be announced, but are well regarded as they're coming into play by next holiday season. The demand on the current console business is just off slightly, more than we would have anticipated. And some of the things that are filling in the space that always happens when a gaming cycle happens, are coming in at lower price points. The demand is quite good but is coming in at lower ASP. So, based on those factors and looking at where the category is in this cycle in advance of its next route that would probably indicate why we see some softness more than we expected.

**Curtis Nagle**

And Matt, I think, you alluded to this in some of your commentary in terms of I think that 4Q, but what are you guys expecting in terms of promotional intensity in the quarter? I know things are very fluid. But, any more color on that would be helpful.

**Corie Barry**

Yes. I think Q4 -- I think, it's always a promotional period. And obviously, we've said it before, it is often used as a traffic driver as that eye catching price point. We would continue to expect that to be the case in this Q4. I think, we continue to expect the deals to start earlier and to last longer, I mean all of the things that we've pretty consistently been saying. I don't see anything that's wickedly out of the ordinary or anything in front of us that looks completely different. But, it's always a promotional period. And I give our teams a ton of credit for their ability to plan for and then really effectively manage through any great Q4.

**Operator**

Our next question comes from Simeon Gutman of Morgan Stanley. Please go ahead.

**Simeon Gutman**

Just to clarify something on the guidance, and this -- I guess, on cautiousness about or uncertainty consumer spending in the back half. It sounds like that's entirely pushed into the fourth quarter, right, there you're not seeing anything that gives you pause around the third quarter. And Corie, I think you mentioned it's a mix of tariff uncertainty as well as a little bit of category uncertainty. And then, just as part of that and you were asked this earlier, Corie, if you look at like the In-Home Advisor business, not seeing anything where conversion is being affected or you're seeing lower tickets or just consumers taking a longer time to decide to convert on orders?

**Corie Barry**

I'll start with the latter from an IHA perspective. We're not seeing really any changes in behavior as we continue to -- and that's why we made a point that we continue to ramp our IHAs, and we're matching that to the demand that we're seeing. And we continue to really like how that business is performing, so not really seeing anything there. Matt, I don't know if you have any comments on the overall top-line.

**Matt Bilunas**

No. The overall top-line, I think like we said, we see categories come up and down, like we always do. As we look at this point in the year, gaming is -- like we said is the biggest sequential drag as you look at the back half. I think, the rest of the categories as you look into Q3 are kind of like what we expected them to be, gaming be a little bit of a change. I think, there is also what Corie said earlier, there is always a level of caution as you look at the back half of the year with this type of market. Most of that is probably geared toward Q4, but there is also a little bit over in Q3 as well as we start to see and the tariffs start to come in.

**Simeon Gutman**

My follow-up, just one more on lease-to-own. Can you share with us -- I'm assuming your expectation is that it's going to bring in -- or you're going to find new customers into the business. But, can you tell us thus far in the markets that it's been rolled out. Is it just -- is it an existing customer who is just electing to finance their purchase differently or is it a new customer to Best Buy?

**Corie Barry**

We definitely are seeing some level of new customer. I mean, between the new customers that we're seeing and what I call reengaged or people we haven't seen very frequently, that's actually the majority of who we're seeing use the program. So, we like the fact that it's engaging for us a very different customer, maybe one that's been less frequent with us.

**Operator**

Our next question comes from Brian Nagel of Oppenheimer.

**Brian Nagel**

Congrats Corie and Matt. A question I have, you thought -- we spent a lot of time talking here about the uncertainty that tariffs and maybe some product cycles you bring to the second half of the year, you've done a great job managing SG&A, even while you are investing, continue to invest in the business. So, the question I have is, to the extent that sales do track a bit choppier or maybe softer over the next few quarters, what leverage do you have on the SG&A side? How would you -- how could you react on the SG&A side to offset that?

**Corie Barry**

Yes. I'm going to answer this in two ways. So, first of all, just to directly talk about SG&A, I mean, I think this quarter was a great example of our teams really being able to continue to find cost efficiencies in the business and to continue to manage the business really tightly. And I think, we have a pretty good track record of being able to flex with the business ebb and flow. And so, I feel really good heading into the back half that our teams are well set up, to be able to manage the SG&A in a way that makes sense. That being said, we've been very clear that we're going to continue to invest in the business in ways that are going to bring this strategy to life. And I want to be clear and say, we continue to invest in the business, and we believe strongly in the strategy that we're bringing. And we're going to -- we're going to make those choices as we go through quarter-to-quarter. And so, yes, we definitely can manage what's manageable behind the scenes, but we're also very thoughtfully trying to make sure that we invest. And you've seen the returns on those investments continue to improve. And so, I think, it feels like we're doing the right thing.

That being said, I mean, I know the start of the question is all about kind of the choppiness of the top-line. Here's what I'd say and Matt said it too, we continue to be pleased with people and customers' interest in technology. And while yes, obviously we're trying to take into account the tariffs, that is genuinely, continuously a very quickly evolving situation. And I just want to reiterate that our teams are doing excellent work with mitigation strategies and at the same time, we're already seeing a lot of our vendors make some moves and move considerably some of that products. I mean, we talk about our current percent of COGS. We think next year that percent of COGS could be more like 40%.

And so, I think it's really important to note that while we're talking about a little bit of this choppiness for the back half, the teams and our vendor partners are working together hard to continue to mitigate the impact of those tariffs. And so, yes, we'll continue to work the SG&A, but I also want to be clear, we like where the strategy is going and we continue to have a really strong point of view that customers are interested in that we were coming to market and the products that we have.

**Brian Nagel**

And then, a follow-up -- and I'm going to apologize, because I think half the questions here, to some extent are better than what you've got. So, I'm going to add one more to that. But, if we look at the narrowing of the guidance for the year, and I know to a certain extent we're splitting hairs because we gave small numbers. But you narrowed more from the top end than you did in the bottom end. If tariffs were not an issue, if the tariffs were not something to consider, how would that guidance -- how could that guidance look or that how could the shift in guidance look?

**Corie Barry**

So, this is the hardest question and almost nearly impossible for me to answer, because the tariffs aren't just about how they impact the individual SKUs, they're also about the consumer conditions, the macro conditions. And we've seen -- I mean, tariff has been a point of conversation for almost 18 months now. And so, the constant morphing of tariffs and having that as part of the conversation, it's literally almost impossible for me to strip out and say just List 4 did this. It's more us trying to take that big step back and say, where do we see the implications, where do we see the consumer and how do we think that's going to impact the back half. And again, remember, part of the narrowing of the range is also just what we've seen already in the first six months of the year. So, it's impossible to strip that out.

**Brian Nagel**

I appreciate it. Thank you.

**Corie Barry**

Thank you. Before ending, thank you for the questions. I think that was our last. I would like to thank you, Matt, and congratulate you on your first earnings call, and thank you, Mike, for joining us. And I would also like to remind everyone that we will be hosting an Investor Update meeting on September 25th from the New York Stock Exchange, where we will have the pleasure of sharing with you an update on our strategic progress. The event will be webcast live and additional details can be found on the Investor Relations section of our website. Thank you.

**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.