HD – Q2’23 Home Depot Earnings Call
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PRESENTATION

Operator

Greetings, and welcome to The Home Depot Second Quarter 2023 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 - ***The Home Depot, Inc. - VP, IR & Treasurer***

Thank you, and good morning everyone. Welcome to Home Depot’s second quarter 2023 earnings call.

Joining us on our call today are Ted Decker, Chair, President and CEO; Billy Bastek, Executive Vice President of Merchandising; Ann Marie Campbell, Executive Vice President of US Stores and International Operations and Richard McPhail, Executive Vice President and Chief Financial Officer.

Following our prepared remarks, the call will be open for questions. Questions will be limited to analysts and investors, and, as a reminder, please limit yourself to one question 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 Ted, 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 Ted.

Ted Decker - ***The Home Depot, Inc. - President & CEO***

Thank you, Isabel, and good morning everyone.

Sales for the second quarter were $42.9 billion, down 2.0 percent from the same period last year. Comp sales for the total company, as well as our U.S. stores also declined 2.0 percent from the same period last year.

Diluted earnings per share were $4.65 in the second quarter compared to $5.05 in the second quarter last year. All three of our U.S. divisions posted low-single digit negative comps in the quarter. Our geographic variability narrowed significantly on a sequential basis as weather normalized, particularly in our Western Division and Spring-related categories rebounded relative to the first quarter.

While there was strength in project related categories like building materials, hardware, and plumbing, we continue to see pressure in certain big-ticket, discretionary categories.

Pro sales performance was slightly negative in the second quarter and outperformed the DIY customer. While surveys suggest that Pro backlogs are lower than they were a year ago, they are still healthy and elevated relative to historical norms. Additionally, projects in these backlogs are generally smaller in scale and scope.

In the second quarter, we were pleased with the consumer's engagement with Home Improvement, particularly across small projects, which Billy will discuss in greater detail.

Going forward, as we continue to navigate a unique and uncertain environment, our focus continues to be on operating with agility as we respond to evolving customer dynamics, while also driving productivity and efficiency throughout the business.

In addition, and as we mentioned at our investor conference in June, we operate in a large and fragmented $950 billion plus addressable market. We remain committed to growing the business and believe we are well positioned to continue capturing market share. To that end, I am pleased to announce HD Supply's acquisition of Redi Carpet, a national MRO flooring provider with a proven track record. This acquisition, which closed at the beginning of the third quarter, extends our current product offering in the multifamily customer vertical with 34 locations strategically located throughout the U.S.

Our team will continue to focus on what is most important: our associates and customers. Our merchants, store and MET teams, supplier partners, and supply chain teams did an outstanding job delivering value and service to our customers throughout the quarter, and I'd like to close by thanking them for their dedication and hard work.

Before I close, I would like to send our thoughts and prayers to the people of Maui. While we are thankful that our people on the island are all accounted for, we are heartbroken by the loss of life and extreme devastation that the community must now navigate, and we stand ready to help in the days, months and years ahead.

And with that, I'd like to turn the call over to Billy.

Billy Bastek - *The Home Depot, Inc. – EVP, Merchandising*

Thank you Ted and good morning everyone.

I want to start by also thanking all of our associates and supplier partners for their ongoing commitment to serving our customers and communities.

In the second quarter, as we saw weather improve across the country, most notably in our Western division, we saw an increase in Spring sales and strength in smaller ticket projects. In addition, we saw a continuation of the trend we observed starting in the fourth quarter of fiscal 2022 with softness in certain big ticket, discretionary type purchases.

Turning to our department comp performance for the second quarter… 6 of our 14 merchandising departments posted positive comps including building materials, outdoor garden, hardware, plumbing, tools, and millwork.

During the second quarter, our comp average ticket was slightly positive, and comp transactions decreased 2.0 percent. Excluding core commodities, comp average ticket was primarily impacted by inflation across several product categories as well as demand for new and innovative products.

Deflation from core commodity categories negatively impacted our average ticket growth by approximately 160 basis points during the second quarter, driven by deflation in lumber. During the second quarter we saw a significant decline in lumber prices relative to a year ago. As an example, on average framing lumber was approximately $420 dollars per thousand board feet compared to approximately $715 dollars in the second quarter of 2022, representing a decrease of over 40 percent.

Turning to total company online sales, sales leveraging our digital platforms increased approximately 1 percent compared to the second quarter of last year. We're excited about our customer engagement across our interconnected platforms as we continue to remove friction from the experience. We know the vast majority of our customers engage with us in an interconnected manner. Whether it be through project inspiration and research, transacting, fulfillment, or support, our customers blend the physical and digital worlds. For those customers that chose to transact with us online during the second quarter, nearly half of our online orders were fulfilled through our stores.

During the second quarter, Pro sales were slightly negative and outpaced the DIY customer. While surveys suggest that Pro backlogs are lower than they were a year ago, they are still healthy and elevated relative to historical norms. And in the second quarter, we saw strength across many Pro heavy categories like gypsum, fasteners and insulation. In addition, we continued to see strength across smaller projects with positive comp performance in a number of categories including: live goods, hardscapes and landscapes.

Big-ticket comp transactions, or those over $1,000, were down 5.5 percent compared to the second quarter of last year. After three years of unprecedented demand in the home improvement market, we continue to see softer engagement in big ticket discretionary categories like patio and appliances that likely reflects both pull-forward of these single item purchases and deferral.

Our merchandising organization remains focused on being our customers' advocate for value. This means continuing to provide a broad assortment of best-in-class products that are in-stock and available for our customers when they need it. We will also continue to lean into products that simplify the project, saving our customers time and money. That's why I'm so excited about the innovation we continue to bring to the market.

This quarter, we are excited to announce the addition of the Milwaukee brand to our assortment of electrical hand tools. Within this assortment we will be introducing a brand-new line of innovative Milwaukee hand tools that provide a high degree of precision with lasting results for our pro customers. We've already seen positive results with our pro customers and feel confident that the addition of these Milwaukee tools will strengthen our position as the number one destination for the electrical trade in the big box retail channel.

Additionally, in kitchen and bath we continue to bring innovation to the market with Glacier Bay. Glacier Bay is one of The Home Depot's top proprietary brands known for performance and style. And this fall we are excited to grow our faucet lineup to include innovative functionality such as touchless and spring-neck designs, add to our assortment of sinks and showerheads, while also expanding into new categories like disposals.

We are also extremely excited about our line-up for Halloween. Our merchants have worked with our supplier partners to put together an expanded assortment of product offerings for this Halloween Season including the return of many fan favorites as well as new collections for the Halloween enthusiast. These products bring excitement to our stores and help drive traffic. And our sneak preview of our Halloween lineup was a tremendous success – We are thrilled for the full roll out in the coming weeks.

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

Ann-Marie Campbell - *The Home Depot, Inc. - EVP, U.S. Stores & International Operations*

Thanks Billy and good morning everyone.

Our store teams have a relentless focus on cultivating the best customer experience in home improvement. We know that our associates are a key differentiator, and they are essential in helping us sustain the customer experience we strive for. In order to provide the best customer experience in home improvement, we must focus on cultivating the best associate experience in retail. This means not only investing in competitive wages and benefits, but also providing tools, training, and development opportunities that make working at The Home Depot an enjoyable and rewarding experience.

I am happy to share that our approximately $1 billion annualized compensation investment that we announced earlier this year is having the intended effects. This quarter we continued to see meaningful improvement in our attrition rates, particularly among our most tenured associates. More consistent staffing levels are resulting in improved customer service, productivity, and safety. These improvements are exactly what we set out to achieve with this wage investment.

In addition to investing in our associates, we must also leverage technology to further simplify both the associate and customer experience.

As you heard at our investor and analyst conference in June, our customers' journeys differ. Depending on the project they are working on, they shop with us in different ways. There is the unassisted, cash and carry purchase, which represents the significant majority of our in-store sales. And the remaining sales are assisted purchases, where customers need help in purchasing a product, a service or an installation.

It is critical that we have the right products in-stock, in the right quantity and on the shelf available for purchase, particularly for unassisted sales. That's why you hear us talk about our focus on improving our on-shelf availability, or "OSA", positions. We are working to narrow the gap between what is considered "in stock", meaning our systems indicate it is in store, versus "on the shelf" and available for sale for the customer. We are doing this by starting to leverage new technology, such as Computer Vision. Computer Vision enables technology to do what we previously relied on associate eyes to do and provides specific locations of depalletized product that is stored in our overhead.

To start, associates will take a picture of bays using their hdPhones. These images then feed into our systems and provide a single, real-time view of inventory that can then seamlessly integrate into applications like Sidekick. Powered by machine learning, Sidekick directs associates to key bays where OSA is low or outs exist. This helps our teams prioritize the highest value tasks inside their respective stores. The beauty of the machine learning model is that the algorithm is continuously learning as Computer Vision images are captured and Sidekick tasks are completed, so it will get better and better at directing our associates to the right bay at the right time. While it is early days, as we have begun implementing this technology, we have seen meaningful improvements in OSA, increased associate engagement and productivity, and higher customer service scores.

In terms of our assisted sales experience, we have worked to improve this experience by enhancing our systems and processes, and have made significant strides. Historically, our associates had to navigate dozens of different systems. Over the last several years, we've invested to simplify the order management system in our stores with the introduction of Order Up. We've created a more robust, intuitive system that is easy for the first day associate to use. This system enables any associate to more easily serve customers across a number of different applications - whether that's picking up an order, placing an order, changing an order, or scheduling a service or installation. Not only does Order Up make it easier to fulfill a customers needs, but it also frees up more time for associates to spend serving customers that need assistance while in our stores. These enhancements have made the average "Order Up" experience over 40% faster for the customer, which has also led to improved customer service scores.

These initiatives are just a few examples of the many different types of projects that can drive significant impacts for our customers, our associates, and our shareholders.

I am so excited about all that our store teams are doing to focus on both the customer and associate experience. None of this would be possible without our amazing associates and I want to thank them for all they do to take care of our customers.

With that, let me turn the call over to Richard.

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

Thank you Ann and good morning everyone.

In the second quarter, total sales were $42.9 billion dollars, a decrease of approximately $900 million dollars, or 2.0 percent from last year.

During the second quarter, our total company comps were negative 2.0 percent, with comps of negative 2.6 percent in May, negative 3.3 percent in June, and negative 0.2 percent in July. Comps in the U.S. were negative 2.0 percent for the quarter, with comps of negative 2.6 percent in May, negative 3.3 percent in June, and negative 0.4 percent in July.

As you heard from Billy, during the second quarter, we continued to experience lumber deflation compared to the prior year. While lumber prices were down, we saw an improvement in unit productivity resulting in a net negative comp impact of approximately 85 basis points versus the second quarter of 2022.

In the second quarter, our gross margin was 33.0 percent, a decrease of 8 basis points from the second quarter last year, primarily driven by pressure from shrink.

During the second quarter, operating expense as a percent of sales increased approximately 100 basis points to 17.6 percent compared to the second quarter of 2022. Our operating expense performance during the second quarter reflects our previously executed compensation increases for hourly associates as well as deleverage from our topline results.

Our operating margin for the second quarter was 15.4 percent, compared to 16.5 percent in the second quarter of 2022.

Interest and other expense for the second quarter increased by $49 million dollars to $428 million dollars, due primarily to interest on our floating rate debt as well as higher debt balances than a year ago.

In the second quarter, our effective tax rate was 24.4 percent, up from 24.3 percent in the second quarter of fiscal 2022.

Our diluted earnings per share for the second quarter were $4.65, a decrease of 7.9 percent compared to the second quarter of 2022.

During the second quarter, we opened 2 new stores bringing our total store count to 2,326. Retail selling square footage was approximately 241 million square feet.

At the end of the quarter, merchandise inventories were $23.3 billion dollars, down $2.8 billion dollars compared to the second quarter of 2022, and inventory turns were 4.4 times, down from 4.5 times last year.

Turning to capital allocation…after investing in our business and paying our dividend, it is our intent to return excess cash to shareholders in the form of share repurchases.

- During the second quarter, we invested approximately $800 million dollars back into our business in the form of capital expenditures.
- And during the quarter, we paid approximately $2.1 billion dollars in dividends to our shareholders and we returned approximately $2.0 billion dollars to shareholders in the form of share repurchases.

Computed on the average of beginning and ending long-term debt and equity for the trailing twelve months, return on invested capital was approximately 41.5 percent, down from 45.6 percent in the second quarter of fiscal 2022.

Now I will comment on our guidance for fiscal 2023.

Today we are reaffirming our guidance for 2023.

- We expect fiscal 2023 sales and comp sales to decline between 2 and 5 percent
- We are targeting an operating margin between 14.3 and 14.0 percent for the year.
- Our effective tax rate is targeted at approximately 24.5 percent
- We expect interest expense of approximately $1.8 billion dollars
- And we are anticipating between a 7 and 13 percent decline in diluted earnings per share compared to fiscal 2022

In addition, we continue to focus on driving productivity in the business and feel confident that we will realize the previously announced $500 million in annualized cost savings in 2024.

We also remain focused on meeting the needs of our customers with our leading product authority in home improvement, strong in-stock levels, and knowledgeable associates. We will continue to prudently invest to strengthen our competitive position, and leverage our scale and low-cost position to outperform our market and deliver shareholder value.

Thank you for your participation in today's call, and Christine we are now ready for questions.

QUESTION AND ANSWER

Operator

[Operator Instructions] Our first question comes from the line of Chris Horvers with J.P. Morgan. Please proceed with your question.

Chris Horvers – *JP Morgan, Analyst*

Thanks. Good morning, everybody. So I think the big question is for the industry, have we seen the bottom? You did a down 4.5% in the first quarter and you did the down 2% in the second quarter, July was flat, so how are you thinking about the trends going forward? Was there anything in the second quarter that we shouldn't extrapolate on a go-forward basis whether that was weather shift or was there something about July that benefited that month in particular?

Ted Decker - ***The Home Depot, Inc. - President & CEO***

Good morning, Chris. It's Ted. The quick answer is yes. July really was a weather shift. We had a particularly wet and cold June and without weather shift, the months of the second quarter were all sequentially about that same minus 2%, but to answer your question from a more macro perspective on where we see the industry and the demand, just start by saying, as you all know, we looked at 2023 as a year of moderation after the explosive growth we had the prior few years and as we called out, consumers would be shifting their spending from goods to services, and while that shift is happening, the overall economy and the consumer in particular have remained incredibly resilient.

As we all know the economy continues to grow. The number – another great GDP print for the second quarter and fears of a recession or at least a severe recession have largely subsided and the consumer is generally healthy. There's PCE spending continues to grow, albeit at a slower rate, and if you look at the home improvement customer, our core customer, the homeowner, they've seen continued growth in home equity over the last several years, strong job growth and increases in wages, so that the core customer remains strong, and if you look at Home Depot, you look at our operations, what we can specifically control, we feel great about where we are halfway through this year, as you saw the meaningful reduction in inventory. We think our inventory positions are better placed than they've been in the past few years. Our in-stock rates have continued to improve. Our value proposition remains strong and as Ann called out, the wage investments are really paying off, but given all those positives, in that we were pleased in the second quarter, uncertainties remain, Chris.

We don't know how quickly or further the share shift in PCE will occur and where spending in home improvement in particular will ultimately settle and we don't know how the monetary policy actions, which are specifically intended to dampen consumer demand, what that impact will ultimately have on consumer sentiment in the overall economy. And as I said, while we did see the sequential improvement in our comp sales, a lot of that was a seasonal recovery in the second quarter and as I said specifically, in July, as well as the impact of lumber is beginning to abate.

And as Billy called out, we do continue to see pressure in certain big-ticket discretionary categories, so while there's a lot of positives in the macro, and with the consumer, we still see enough uncertainty, really largely driven by this PCE shift and where that ultimately lands that we – while again we feel good, we just thought there was too much uncertainty to take, for example, revise our guidance from earlier in the year. But having said all of that, long answer, when we do get through this period of moderation, we remain incredibly bullish on the sector. We couldn't feel better about the macro for housing and home improvement, in our prospects and ability to keep taking share in this huge and still largely fragmented market.

Chris Horvers – ***JP Morgan, Analyst***

Thank you for that. My follow-up question is, is on the ticket side. I mean, you are, if you run stacks or CAGRs on your average ticket, it did deteriorate in the second quarter relative to the first, so can you talk about the drivers of that and how much of that is this shift to smaller ticket projects accelerating, because you're going to start to lap through that ticket pressure in the fourth quarter, so is what you're seeing now indicative of that shift from large to small is accelerating so we can't just assume that we sort of annualize that out in the fourth quarter.

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Well, Chris, this is Richard. First, just with respect to stacks and progression. What we're encouraged by is we're seeing – as cost pressures in our industry sort of abate, we're seeing ticket and transactions actually begin to converge and we think that that's actually a healthy signal in the business, so I think that's the most macro comment that we could make about ticket progression.

With respect to large versus small projects. Certainly, our customers and our contractors tell us that there is some stance of deferral when it comes to large projects. Customers are opting for – they're more likely to opt for smaller versus larger and that may have some impact on ticket, but we're also seeing the impacts of what we call softness in certain large ticket discretionary item purchases, like patio and appliances, so there's a lot going on there. But I think, that the – maybe the most important dynamic is just kind of that nice recovery in transactions as both ticket and transactions begin to converge and normalize.

Chris Horvers – *JP Morgan, Analyst*

Understood. Thanks very much.

Operator

Our next question comes from the line of Michael Lasser with UBS. Please proceed with your question.

Michael Lasser - *UBS, Analyst*

Good morning. Thank you so much for taking my question. Given this trend of small transactions coming in and maybe even replacing large transactions, is it more likely that you can take the low-end of your guidance off the table of a downsized comp for the year outside of some macroeconomic shock at this point?

Ted Decker - *The Home Depot, Inc. - President & CEO*

Well, Michael, I don't want to go through the answer I just went through with Chris.

Michael Lasser - *UBS, Analyst*

I hear you.

Ted Decker - *The Home Depot, Inc. - President & CEO*

But, that pretty much laid out the view. I mean, again, we feel really good about the second quarter. Clearly, we like the sequential improvement, and as Richard said, the normalization and settling, if you will, of a much-healthier balance of ticket and transactions, but there's still just a lot of uncertainty. Is the Fed going to raise? Are we going to get a budget deal passed? I mean, there's so many things out there swirling that we just updated or reaffirmed in June that we're just more comfortable standing pat right now.

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

And the other thing just to at least know that we're watching is our share of PCE. We've watched this since our sales spiked in 2020 as not a perfect measurement, but certainly a way to think contextually about what we saw during the three years of unprecedented growth.

As predicted, we've seen our share of PCE. As Ted mentioned, as we've seen share shift from goods into services, we have also seen our share of PCE steadily revert back towards 2019 levels. When you think about the bottom-end of our sales guidance, that actually corresponds with the math that would say if our share of PCE reverted all the way back to 2019 levels, that would imply the low-end of the guidance.

We don't see anything in our business today that tells us that that's the trajectory, but that is the math of our PCE share shift and I'd also just repeat, Ted, we're not sure where that share ultimately settles. The home is so much more important from a financial perspective for, you'd say, all homeowners than it was three years ago that perhaps there's an elevated level of home improvement spend in PCE versus prior years. We just don't know but that low-end of the range does correspond to the PCE share shift math.

Michael Lasser - ***UBS, Analyst***

Understood. My follow-up question is Home Depot's operating expenses this year are being impacted by the $1 billion wage investment, but SG&A growth over the last few years has been anything but normal. So, the key debate here is has the company entered a period where the cost of doing business has just gone up such that even if the cycle recovers in 2024, the company won't see a significant improvement in its profitability because so much will need to be reinvested back in operating expenses based on what's happening right now?

Ted Decker - ***The Home Depot, Inc. - President & CEO***

Well, I wouldn't paint that picture, Michael. Clearly, too early to talk about 2024 but we made a significant investment in wage, as Ann said, and we're in a much more comfortable position on a national minimum level and where we are in competitive markets. So again, as Ann mentioned, we couldn't feel better about the returns on that investment. We don't expect that we're going to need to make that outsize of an investment in the near-term planning horizon. Wage rates are still up, but we're seeing those come down, annual increases, that we track month-to-month as I'm sure you do, are moderating, so we don't see another big wage investment and then this business as it always does will leverage with volume and those dynamics of this P&L leveraging with modest comps, that investment thesis remains intact.

Michael Lasser - ***UBS, Analyst***

Got you. Thank you so much...

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

It might just do to remind as we laid out in the investor conference, in a market normalized case with 3% to 4% top line growth in the normalized case we expect margin expansion, based on operating expense leverage that would lead to mid-to-high single-digit EPS growth, so nothing has really structurally changed that much, but it is worth just pointing back to our comments in June.

Michael Lasser - ***UBS, Analyst***

Understood. Thank you so much and good luck.

Operator

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

Zack Fadem - ***Wells Fargo, Analyst***

Hey. Good morning. Can you help us unpack the cadence of DIY versus Pro from Q1 to Q2? As last quarter saw DIY outperform Pro for I think the first time in two years and with that reversing out in Q2, curious how you think about the moving parts between the two and if we should expect the spread to widen or contract going forward.

Ted Decker - ***The Home Depot, Inc. - President & CEO***

Zach, I wouldn't read too much into that. There was so much noise in Q1 that I'd just say that was an outlier and the theme of the Pro responding to the investments we're making in outperforming the consumer that we just saw in Q2 is consistent with what we've seen but for an outlier very noisy Q1.

Zack Fadem - ***Wells Fargo, Analyst***

Got you. And, Richard, you had talked about the $500 million in cost savings next year coming out of the base, but I believe there's also about 10 bps to 20 bps of productivity benefit this year and I'm hoping you could speak to first of all the differences between the two and the buckets of savings, and then whether that 10 to 20 bps for this year is in the base today or if it builds through the year.

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Sure, Zach. Thanks. Yeah, that 10 to 20 basis points is something we called out at the very beginning of the year, when we – or – and actually – when we talked about the progression of margin and so – or rather the range of operating margin outcomes. That – you can think of that as really productivity that we anticipated in ordinary course. It certainly offset expenses such as the wage investment, but it was part of our original guidance and consistent with revised guidance in Q1 and consistent with guidance today.

The $500 million cost-out that we anticipate for 2024 is separate and it really reflects our – the rationalization in most parts of a cost structure that we had to build up as we saw product volume skyrocket in 2020 and 2021, so we built a cost structure that isn't necessary today in today's volumes, and so we will rationalize some of that cost structure.

A good example would be a warehouse that we took a lease on to hold products during 2020 and 2021. We are looking at our real estate footprint, and some of that may well be rationalized. Those are the – and with that comes cost savings. That's the nature of the $500 million. Think about it as a permanent reduction in our fixed-cost base.

Zack Fadem - ***Wells Fargo, Analyst***

And all these are SG&A, right, just to confirm?

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

There's probably some – there could be some geography in COGS and in operating expense, but we haven't settled on that yet. To your question and let me just make sure that we're clear. That initial 10 to 20 basis points of productivity is included in our operating margin guidance for 2023. No part of the $500 million is included in 2023. That is assumed full year benefit annualized in 2024.

Zack Fadem - ***Wells Fargo, Analyst***

Got it. Appreciate the time. Thanks, Richard.

Operator

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

Scot Ciccarelli - ***Truist, Analyst***

Good morning, guys. You talked about relative strength in the smaller project spending, but in an environment with negative Pro sales and smaller Pro backlogs, how are you guys benchmarking your efforts to gain traction in the large and complex Pro business you'd spent a lot of time talking about?

Hector Padilla - ***The Home Depot, Inc. – EVP, Outside Sales & Service***

Hey, Scot. This is Hector. Good morning. As we mentioned in the investors conference, what we are building as far as the ecosystem for the Pro, it is hard and it will take some time. Now the good news is, they will also be very hard to replicate as you know, and today, we're very encouraged by the signals that we are getting from our Pro customers as they engage with different pieces of the ecosystem.

We are in many markets today with the expanded ecosystem. There are pieces of the ecosystem that we don't have fully deployed. Think of an order management system or direct credit, but we continue to gauge our performance with our Pros. Those Pros continue to engage not only in the supply chain assets that we have built and with our outside sales resources as we expanded that team, but they are visiting our stores in a more frequent basis, so we continue to be very encouraged by what that cohort is… how it's performing, and we'll continue to invest in the efforts.

Scot Ciccarelli - ***Truist, Analyst***

Okay. Got it. Thank you, Hector, and then just a second question. Inventory was down quite a bit even with the negative comp. Would you guys expect that to mark the bottom of your destocking process or should we expect inventory levels to continue to drop? Thanks.

Billy Bastek - ***The Home Depot, Inc. – EVP, Merchandising***

Well, we're pleased with the progress we've made relative to our inventory position and you think about everything that's happened in the supply chain and lead times associated with that has helped. We – listen, we still have work to do to improve productivity, but we feel good about our inventory and we have low obsolescence risk and super-experienced merchant team, so a lot of the dynamics in the supply chain helped us really and at the same time, I might add, our in-stocks are better than they've been since before the pandemic, so we're really pleased about the inventory productivity, but at the same time, our in-stocks, our ability to be in-stock below [indiscernible] (00:41:00) as Ann called out, our OSA, so really pleased with both of those pieces.

Operator

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

Jacquelyn Sussman - ***Morgan Stanley, Analyst***

Hey, there. This is Jackie Sussman on for Simeon. Thanks so much for taking our question. You were speaking earlier on small projects replacing large projects. Can you drill into the backlogs a bit more? How much have they come off of peak? How far above normal levels are they, and is there any evidence you're seeing that consumers are fully pushing off or canceling projects rather than just trading down? Thanks.

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Well, I'll start on that one. And it's – we rely on publicly published surveys. The one that we watch is the National Association of Homebuilders Index. We have seen backlogs decline sequentially, but yet they are well above the historical average and so you'd really say the professional customer has been oversubscribed for so many years that they still may have a full book of business, just not maybe oversubscribed, they may be taking phone calls again, but they are very healthy.

Again, you think about the historical average, and you can look this up, but historical average being a score of a 50, the index is still at a 61, so down from peak, but higher-than-average.

Ted Decker - ***The Home Depot, Inc. - President & CEO***

In addition to the publicly available indexes, obviously, we have millions of Pros and the field sales force that Hector mentioned, so anecdotally we're getting loads of feedback from our customer base. They're still busy and engaged with those backlogs, but it's their commentary to our sales force that they're smaller, so that's where we get the color on that dynamic.

Jacquelyn Sussman - ***Morgan Stanley, Analyst***

Got it. That's helpful color. And just one quick follow up. Shrink was the only real call out on the gross margin line. Can you talk about how that trended in the quarter? Did it get worse or any better, and if there are any actions that you're taking to mitigate that impact going forward?

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

From a financial perspective, shrink has been a consistent pressure over the last several quarters and even last few years, and it's something we're tackling every day. And Ann maybe?

Ann-Marie Campbell - ***The Home Depot, Inc. - EVP, U.S. Stores & International Operations***

Yeah. No. We are certainly in the battle in retail as we kind of think about shrink, but we've always continued to lean into initiatives that we've seen that can have impact to mitigate overall, and I know, it's early as we think about the Inform Act, but the Inform Act is one of the key components as we think about organized retail crime that I think will help give us a little bit more visibility in some of the things that are happening out there, but certainly it's been largely in-line with what we've seen in the last several quarters. We certainly have key initiatives to help mitigate that and we need all kind of government partners to help on their end as well to help us in retail to really mitigate what we're seeing out there.

Jacquelyn Sussman - ***Morgan Stanley, Analyst***

Got it. Thanks so much.

Operator

Our next question comes from the line of Steve Zaccone with Citi. Please proceed with your question.

Steve Zaccone – ***Citi, Analyst***

Great. Good morning. Thanks very much for taking my question. I was hoping you could comment a bit more about the homeowner engagement that you talked about. Sounds like it was a bit of a sequential improvement. Was that largely weather-driven or are you actually seeing some elasticity of demand as inflation eases in some categories?

Billy Bastek - ***The Home Depot, Inc. – EVP, Merchandising***

Yeah, thanks, Steven. No, I think, we articulated earlier about the weather patterns. We actually talked in Q1 about the impact that the West had. The West is our best-performing region, best-performing division for Q2, so we saw a lot of that engagement back into those spring categories. We pushed a little bit around from June to July with some of the weather and the heat as you saw more in ACs and fans, so a much more normalized balance to the quarter outside of just some shifting of some of those smaller seasonal pieces.

Steve Zaccone – ***Citi, Analyst***

Okay. Great. And then just a clarification on second half expectations. Is there any difference in how you're thinking about the business in the third quarter versus the fourth quarter comps, and then maybe a more near-term question. If July benefited a bit from weather how has August to-date trended? Is it fair to say you're back within that full year guidance range?

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Right. So the first two weeks of the third quarter have been a little better than our first half comp, but we have 24 weeks left in the year, so we think the guidance range is appropriate.

Steve Zaccone – ***Citi, Analyst***

Okay. And then just third quarter versus fourth quarter? Should we just kind of look at the one-year comparisons?

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

We're not going to provide quarterly guidance, and again, we've got 24 weeks left in the year, so we think the range is appropriate.

Steve Zaccone – ***Citi, Analyst***

Okay. Thanks. Best of luck in the back half.

Operator

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

Chuck Grom - *Gordon Haskett, Analyst*

Thanks very much, great quarter. You committed to investing $1 billion in wages this year, but as comps and transactions have remained negative and the flexibility that you have with the transaction-based labor model, is there the potential for that full amount not to be realized or will you reinvest it in other parts of the business?

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

Well, from a financial perspective, of course, there's an assumption around how many hours would be utilized during the year. There's something that has to be multiplied against the wage, but I wouldn't say this is a material – you're not going to see a material change in our financial portfolio and again our guidance is the best guideline for you to look at with respect to our annual – likely annual performance.

Chuck Grom - *Gordon Haskett, Analyst*

Okay. Great. Thank you. And then for Ann, just can you elaborate a little bit more on the computer-vision technology, how quickly is that going to be rolled out across the chain and maybe elaborate on some of the benefits you think you could see in the near term?

Ann-Marie Campbell - *The Home Depot, Inc. - EVP, U.S. Stores & International Operations*

Sure. So first of all, we started with Sidekick application which direct associates to pass down products from the overhead. And so Sidekick is a task tool. Computer-vision helps that associate see where the product is in the overhead, so which is a complementary component to drive overall productivity. So, we are certainly bullish. We have that in a region that's fully rolled out already. We have that in what we consider pilot stores across every single region, and we expect that to be rolled out later this year.

We're seeing some really, really good output, finding product that takes a ton of time in our stores, so I've been around for a long time. My neck looking up in the overheads trying to find product for customers, and we have thousands of associates that's doing that every day. So complementing, directing the task and then finding exactly where the product is in the overhead drives a ton of productivity for us and we expect to roll that out later this year.

Operator

Our next question comes from the line of Brian Nagel with Oppenheimer. Please proceed with your question.

Brian Nagel - *Oppenheimer, Analyst*

Hi. Good morning. Thanks for taking my question. So, at the risk of being maybe a bit repetitive, I just – with regard to inflation, I guess maybe now disinflation, which we're starting to see, and I know, you mentioned in your prepared comments the lumber price dynamic that we're seeing in improved unit demand, but the question I have is, we're seeing – we're moving past maybe peak-ish inflation, and getting more to a state of disinflation, how are you seeing overall business flex? Both from a – I guess, from what you're doing, as well as how your consumers are reacting generally.

Ted Decker - ***The Home Depot, Inc. - President & CEO***

I mean, broadly on the inflation piece, well, we still expect that the overall year will have a net inflationary impact on our costs in retails, but as we go into the second half, it is moderating. When you look at just the activity of cost increase requests, they're negligible. I mean, there are a couple and we were in the billions of dollars at one point of cost in, and so net new requests for cost and certainly cost increases in the supply chain, that's all completely abated.

As we go into the second half, when you think of product cost, transportation, overall transportation costs and then what ultimately do in retails, inflation has certainly abated. Commodity is certainly down meaningfully from the peak as well as year-over-year as well as even shorter term, but beyond commodity and the fact that we don't have increased inflation, we're not expecting a deflationary environment.

I think, Richard used the term settling. We're kind of settling into these non-commodity price levels and as the Pro and consumer customer has gotten used to those over the last few years, you're seeing the normalization in transactions, as Richard called out, so we're encouraged that the cycle of inflation is essentially behind us and Richard, I don't know, if you or Billy, if you have anything else to add to that?

Billy Bastek - ***The Home Depot, Inc. – EVP, Merchandising***

I'd say we are encouraged by the improvement in transactions and as we see the normalized pieces that Richard spoke about earlier, but we don't see a deflationary environment as we go forward.

Brian Nagel - ***Oppenheimer, Analyst***

That's very helpful. And then the second question I have and I know it's going to be a bit nuanced, but just to understand how your consumers really react here. So as you look at the West Coast, you called out I think it was a point of strength in the quarter or as weather maybe normalized a bit, but the question I have is, as you are watching that consumer reengage with Home Depot amid more normal weather conditions, is there anything there surprising or is the consumer coming back like you would normally expect with a weather shift like we've seen?

Billy Bastek - ***The Home Depot, Inc. – EVP, Merchandising***

Yeah, I'd say, Brian, that we called it out in Q1 because of the impact that we saw and it played out precisely kind of how we thought in the West. As I mentioned, that was our best performing division. Customers engaged heavily in our seasonal businesses that were still pressured into Q1, so it really did play out precisely how we'd thought.

Brian Nagel - ***Oppenheimer, Analyst***

Okay. I appreciate it. Thank you.

Operator

Our next question comes from the line of Mike Baker with DA Davidson. Please proceed with your question.

Mike Baker - ***DA Davidson, Analyst***

Okay. Thanks. Two, please, if I could. One, bigger picture. I think, last quarter, maybe it was in the June Analyst Day, you said that you thought the housing market would be down mid-to-high single-digits in 2023. That was sort of the industry baseline. There's been some indicators of housing being a little bit better. Is that still the way you're thinking about the industry right now is down in that mid-to-high single-digit range?

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Well, we said that there's some economists who might call for that. We were uncertain and that's really because when you look at supply and demand imbalances in the market, we've worked our way into a structural deficit of housing in North America and what's interesting to us is, you've actually seen sequential improvement month-over-month in home prices for the last four months, so I think if you just look at observed data, home prices have, for the most part, remained steady versus last year, and so better than many economists' predictions at the beginning of the year.

Mike Baker - ***DA Davidson, Analyst***

Okay. So – but has your view changed at all or too much uncertainty?

Ted Decker - ***The Home Depot, Inc. - President & CEO***

Yeah, I think the big story with housing now as it's playing out is values have held up. And Case-Shiller just came out with some data, and Redfin just came out with some data that, that drop off in values has been erased, and that we're now back to record highs of home values in the United States, and sequential improvement as Richard just said.

The near-term story in housing is that with so many people locked into the incredibly low mortgage rates that there just isn't a lot of inventory available for sale, so transactions are at certainly near-term lows in terms of nominal number of houses that are turning over in a percentage of the housing stock, as so many people are below 5%, even at 3% mortgage rates, so values are holding if not now back increasing, fundamental imbalance again at 2 million to 3 million to 4 million homes, and the issue is inventory and people are getting used to it.

We understand new buyers have sort of digested the increase in mortgage rates to the 7-ish-percent, but there's just not that much available to purchase.

Mike Baker - ***DA Davidson, Analyst***

Yeah. Okay. Makes sense, sorry that was one question. The follow up is this, if I could. You'd said I hate to be so short-term focused, but August was better than the first half comps, but any comment on August versus the second quarter comps?

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Again, first two weeks of the quarter are a little better than our first half comp. We have 24 weeks left and so we'd just -we'd point you back to our guidance.

Mike Baker - ***DA Davidson, Analyst***

Okay. Fair enough. Thank you.

Operator

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

Karen Short - ***Barclays, Analyst***

Hi. Thanks very much. So two questions. The first is when you think about the dynamics on DIY versus the Pro, in terms of the impact to your second half comp, and then into 2024, how are you thinking about DIY in terms of recovery? And I think, it's pretty clear where you stand on the backlog with the Pro, but I think DIY is the big question in terms of how that customer will feel and is going to feel in the second half.

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Well, we don't – I think at the end of the day, it's all the same demand and whether the Pro is fulfilling that demand or not, it's sort of all the same, so I wouldn't – I actually would view it as saying we feel good about where our Pro business is. We feel good about the entirety of it, really. We don't know where those trends will go. But, again, we know our Pros say their backlogs are healthy.

Ted Decker - ***The Home Depot, Inc. - President & CEO***

I was just going to say the consumer – the nearest term view of consumer is the engagement in seasonal is led by the consumer. Certainly, the garden business. But also things like exterior painting and stain, and when the weather improved, consumer responded, and it was really steady, constructive demand, so what we expect going forward, I think you look at all those macro comments we mentioned earlier that are consumers a homeowner? 80-odd percent of them own their homes, up – tremendous equity value in that home, great jobs, great income and it's a very healthy consumer segment in the overall economy.

So, seeing their engagement in Q2 as weather improved, seeing their engagement in something like Halloween. I mean, it's not an enormous business for us, but to say unbelievable engagement, Billy, in that product category, which is 100% discretionary, is a pretty decent telltale of engagement in the sector.

Karen Short - ***Barclays, Analyst***

Okay. That's really helpful. Thank you. And then my second question is, Richard, you always discussed your ability to flex SG&A with respect to labor, but then also inventory rapidly, based on the comp, in order to maintain stability with operating margins, so I guess my question is, with the recent wage investments, do you still have the same flexibility within the same timeline in general, with that rule of thumb in mind?

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Absolutely. I mean, you'd say that the jumping off point would be post-wage investment, but post-wage investment we have the same degree of flexibility we have always had.

Karen Short - ***Barclays, Analyst***

Okay. Thanks very much.

Isabel Janci - ***The Home Depot, Inc. - VP, IR & Treasurer***

Christine, we have time for one more question.

Operator

Thank you. Our final question comes from the line of Steve Forbes with Guggenheim. Please proceed with your question.

Steven Forbes - ***Guggenheim, Analyst***

Good morning, everyone. So just two quick follow-ups. The first on ticket. Curious if you could expand on DIY ticket versus Pro ticket trends, as we think about sort of second-half complexion. And then maybe if you could just speak to what the full year comp implies in terms of ticket, if it's still positive as you see it today.

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

We've – I'll just – I'll answer the second part first and then I'll turn it to Billy. Again, we've got 24 weeks to go. We're not going to break out ticket and transaction within our guidance other than just to repeat we're encouraged by what we've seen with respect to settling of ticket and recovery and transactions. Billy?

Billy Bastek - ***The Home Depot, Inc. – EVP, Merchandising***

Yeah, and as we called out just on the lumber piece alone, we'll see that abate as we get to the back half of the year and it'll be much less of an impact than we saw in the first half overall.

Steven Forbes - ***Guggenheim, Analyst***

And then just lastly as we think about the Dallas market, the 350 basis points you guys noted as of 2022, at the Analyst Day presentation, any update on how that market is trending year-to-date 2023 versus the company average?

Hector Padilla - *The Home Depot, Inc. – EVP, Outside Sales & Service*

Yeah, no. Steven. It's Hector again. We continue to be very encouraged by the results in Dallas, and we have scaled a lot of the capabilities that we first implemented in Dallas to all the markets. And we're seeing very similar and encouraging results, so we see the customers engage, not just with the delivery sales, but also again back in our stores and through our online digital platforms, so continue to be very encouraged about the performance.

For us Dallas has been a success so far, and we continue to deploy capabilities to round out the ecosystem in Dallas, and again in other markets as we test-and-learn and deploy capabilities at scale.

Steven Forbes - *Guggenheim, Analyst*

Thank you.

Operator

Ms. Janci, I would now like to turn the floor back over to you for closing comments.

Isabel Janci - *The Home Depot, Inc. - VP, IR & Treasurer*

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

Operator

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.