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BBY.N - Q2 2022 Best Buy Co Inc Earnings Call

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OVERVIEW:

Co. reported 2Q22 enterprise revenue of $11.8b and non-GAAP diluted EPS of $2.98. Expects FY22 enterprise revenues to be $51-52b.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to Best Buy's Second Quarter Fiscal Year 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded for playback and will be available by approximately 11 a.m. Eastern Time today. (Operator Instructions) I will now turn the conference call over to Mollie O'Brien, Vice President of Investor Relations. Please go ahead.

Mollie O'Brien - *Best Buy Co., Inc. - VP of IR*

Thank you, and good morning, everyone. Joining me on the call today are Corie Barry, our CEO; and Matt Bilunas, our CFO. 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 condition, business initiatives, growth plans, investments and expected performance of the company and are subject to risks and uncertainties that could cause actual results to differ materially from such forward-looking statements. Please refer to the company's current earnings release and our most recent 10-K and subsequent 10-Qs for more information on these risks and uncertainties. The company undertakes no obligation to update or revise any forward-looking statements to reflect events or circumstances that may arise after the date of this call. I will now turn the call over to Corie.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Good morning, everyone, and thank you for joining us. Today, we are reporting record Q2 financial results of $11.8 billion in sales and non-GAAP diluted earnings per share of $2.98. Comparable sales growth was 20%, and our non-GAAP operating income growth was 40%. We are lapping an unusual quarter last year as our stores were limited to curbside service or in-store appointments for roughly half the quarter. When we compare to 2 years ago, our results are very strong. Compared to the second quarter of fiscal '20, revenue was up 24%, and our non-GAAP operating income is up 115%. Clearly, customer demand for technology products and services during the quarter remained very strong.

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Customers continue to leverage technology to meet their needs, and we provide solutions that help them work, learn, entertain, cook and connect at home. The demand was also bolstered by an overall strong consumer spending, aided by government stimulus, improving wages and high savings levels. From a merchandising perspective, we saw strong comparable sales growth in almost all categories. The biggest contributors to the sales growth in the quarter were home theater, appliances, computing, mobile phones and services.

Product availability improved in the quarter. And except for some pockets in appliances and home theater, we do not believe it materially limited our overall sales growth. Our merchant demand planning and supply chain teams once again did an amazing job managing through the difficult and constantly evolving supply chain environment. They worked strategically to bring in as much inventory as possible during the quarter with actions like acquiring additional transportation, pulling up product flow, and adjusting store assortment based on availability. There will continue to be challenges, particularly as it relates to congested ports and transportation disruptions. But our teams have set us up for as strong an inventory position as possible as we move forward into the back half of the year.

As we think about the holiday period, we often have varying degrees of inventory and supply chain challenges, and this year will be no different. But we feel confident in our ability to serve our customers during the holiday. The continued strong demand across retail resulted in an overall less promotional environment, which was a significant driver of our better-than-expected profitability in the quarter.

During the quarter, we provided customers multiple ways to interact with us depending on their needs, preference, and comfort. Similar to last quarter, customers migrated back into stores to touch and feel products and to seek in-person expertise and service. At the same time, they continue to interact with us digitally at a significantly higher rate than prepandemic as online sales were 32% of Domestic revenues compared to 16% in Q2 of fiscal '20. Phone and chat volume also remained very high compared to prepandemic, and sales via these channels continue to climb.

In addition, of course, we are interacting with customers in their homes, making large product deliveries, installing solutions, repairing products, and providing sales consultations. In fact, overall, we are helping our customers with their technology needs in their homes 20% more than we did 2 years ago in Q2 of fiscal '20. Through all of these interactions, across all of these touchpoints, 98% of survey customers tell us they feel very safe, which we believe is still incredibly important at this stage in the pandemic. I want to genuinely thank our store and in-home teams for creating this safe environment for our customers and for continuing to provide exceptional service even in situations where customers resisted following safety guidelines and, in some cases, were disrespectful.

For customers purchasing online, we delivered products with speed and convenience. Online sales package delivery was not only much faster than last year, it was faster than 2 years ago. Furthermore, we stack up extremely well versus our competition. Using a third-party service, we analyzed competitor websites on a daily basis, and we consistently lead in the proportion of 1 day or less for published shipping time across a sample of higher-volume ZIP codes and higher-demand items.

In addition, we leveraged our stores to drive fast and convenient fulfillment of online orders. In Q2, we continue to see about 60% of our online revenue fulfilled by stores, including in-store or curbside pickup, ship-from-store or Best Buy employees who are delivering product to customers out of more than 450 of our stores. The percent of online sales picked up by customers at our stores was 42%, similar to last year's second quarter. Clearly, the landscape, as it relates to the pandemic, has been changing rapidly and we remain keenly focused on keeping our employees and customers safe.

We are continuing to encourage all employees to get COVID vaccinations by providing them with paid time off when they receive the vaccine and providing them absence time to be used in the event they develop side effects. In June, we launched an employee sweepstakes with more than $100,000 in cash prices to encourage our team members to get vaccinated. To show our appreciation for their hard work and ongoing efforts in the face of pandemic fatigue, we paid employee gratitude bonuses at the beginning of the quarter. In summary, our team has delivered incredible results. To all of our associates across the company, I thank you for your customer obsession, perseverance, and ingenuity.

Of course, while we were driving these great Q2 results, we were also looking to the future. During the quarter, we continued to roll out and run several tests and pilots as we determine the best path forward to become an even more customer-centric, digitally focused and efficient company. We believe this is crucial to thriving in a new and different environment where customers expect to seamlessly interact with physical and digital channels throughout the shopping journey as they seek inspiration, research, convenience and support.

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Last year, we introduced a very important membership pilot called Best Buy Beta. As a reminder, it includes unlimited Geek Squad technical support on all of the technology in their home no matter where or when you purchased it, including 24/7 VIP access to dedicated phone and chat teams that are only available to members. It also includes up to 24 months of product protection on most purchases from Best Buy, free delivery and standard installation, exclusive member pricing, a 60-day extended return window and free shipping of online orders, all for $199 per year.

The offer is designed to give our customers the confidence that whatever their technology needs are, we will be there to help. It leverages our unique strengths and what we can provide customers that no one else can. The goal is to create a membership experience that customers will love, which in turn results in a higher customer lifetime value and drives a larger share of CE spend to Best Buy. We are very excited about this membership offer, and we are encouraged by the pilot results. Membership acquisition has exceeded our initial forecast. In addition, data is showing that Beta members interact more frequently and have a higher incremental spend than nonmembers. Given the breadth of the offer, it is resonating well across all customer demographics, and our members are skewing younger than our Total Tech Support membership program. In addition, our employees love telling customers about the program.

We plan to scale the program nationally in stores and online at the end of Q3 under the new name Best Buy Total Tech. As part of the national rollout, we will be converting our 3.1 million existing Total Tech Support members to the new program. I want to stress that the goal of the program is for customers to find value in the benefits and use them often. It is not designed to be a stand-alone, margin-driving service offering, particularly in the near term. In fact, as Matt will discuss later, a full rollout is a near-term investment, which we are confident will be justified with incremental sales growth and long-term customer value.

As it relates to our physical stores and operating model, we are continuing to pilot and test many approaches and formats. Specifically, we are testing more experiential stores, how we can leverage our stores and facilities for more fulfillment purposes and how we can deliver customer experiences with a more flexible, digitally supported and engaged workforce.

We are not going to outline all of our initiatives today, but I would like to provide a few updates and learnings. We have begun implementing the pilot of our new holistic market approach in Charlotte. As we mentioned last quarter, this pilot is designed to leverage all our assets in a portfolio strategy across stores, fulfillment, services, an outlet, lockers, our digital app and both in-store and In-Home Consultation labor.

We will be testing an array of different prototypes, including remodeling a number of stores to 15,000, 25,000 and 35,000 square foot stores as well as launching a few new smaller 5,000 square foot stores. We expect the full rollout of the pilot to span a few quarters. And several store remodels are currently underway, including the transition of 1 store into a new type of outlet. Our current 15 outlet stores focus mainly on large appliance and TV open-box product.

With this new outlet pilot, we will have open-box products from all categories. It will also serve as the hub in a new services repair hub-and-spoke model we are testing as well as an auto tech mega-hub for our car tech installation. Of course, the reason we are piloting and testing so much is because we are trying some unique prototypes, and we need the opportunity to learn and adjust before we roll more broadly.

For example, in our 4 Minneapolis test stores where we reduced the shoppable square footage to 15,000 square feet to provide more space for fulfillment, we have been making adjustments based on customer and employee feedback. We've reflowed some of the layouts, added signage to help customers understand the changes we are testing and added assortment in areas like small appliances, printing and accessories. We will continue to evolve these test stores based on learnings and feedback. As it relates to our Houston experiential 35,000 square foot store pilot, we continue to receive positive feedback from customers and employees on store design and the way we are showcasing products. In addition, year-to-date, this store generated higher revenue than control stores in the double-digit percent range.

Another pilot that we are excited to launch preholiday is our virtual store. For this, we are building out a physical store in one of our distribution centers that will have merchandising and products and will be staffed by dedicated associates, including vendor-provided expert labor, but it will have no physical customers. Instead, customers can interact with our experts via chat, audio, video and screen sharing depending on their preference and be able to see live demos, displays and physical products.

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We are excited about the customer use cases this provides. For example, you could be on our dot-com experience, click on a product you like and be connected via video to a Blue Shirt in the Best Buy virtual store and never lead your living room. Or you could be standing in a store, scan a bar code and be taken through your phone directly to this virtual store where an associate could answer your question.

From a fulfillment perspective, our ship-from-store hubs we piloted last year were very successful and we are continuing to iterate on the model. As a reminder, while all stores will continue to ship online orders, we are driving efficiency and effectiveness by consolidating ship-from-store units in a limited number of stores across the country. As we evolve the model overall, we are using fewer stores than last year as hubs.

In addition, we've begun remodeling a subset of stores to deliver an even greater portion of the volume, reducing the sales floor square footage and installing warehouse-grade packaging station equipment and supplies. These 13 locations should be rolled out by holiday and take on about 25% of the national ship-from-store volume. As you would expect, the various tests and pilots are intended to identify how our store portfolio should evolve from the role they serve to their look and feel. As we learn from these tests, we will develop plans that likely include a rollout of investments in more stores and markets.

We have also been evolving our labor model to meet our customers' changing shopping behaviors. For our employees, we are designing for more choice, flexibility and career opportunity. We continue to see momentum with our flexible workforce initiative, which is centered on store employees becoming certified to gain expertise to perform roles outside of their primary job function. At the end of July, 80% of our associates were eligible to flex into different work zones, and 50% of associates have earned 4 or more jobs. This allows our employees and us to schedule shifts more flexibly within the store and between channels, like virtual sales, chat, phone, remote support or employee product delivery. And very soon, we will be able to schedule associates between stores within a market.

This flexibility is important for all of our stores going forward, but even more important for our smaller stores with less labor. This new way of working empowers employees to develop their careers by giving them opportunities to learn new skills, broaden their experience and have more flexibility in their jobs. They are equipped to confidently help customers in more ways. And our data is showing us that once employees add skills they tend to drive a higher customer NPS. It also gives team members the ability to earn a different hourly wage depending on the job performed and the potential for working additional shifts that otherwise may not have been available in their primary job function.

We believe our flexible workforce initiatives can add to our ability to attract and retain our employees, particularly in this tight labor market. And in addition to the training and flexibility we offer, we have also invested significantly in compensation and benefits for our associates. On top of raising our starting wage to $15 last year, we provide a wide array of competitive benefits across many dimensions, including tuition reimbursement, employee product discounts, paid time off for part-time associates, backup child care, child tutor reimbursement, mental health support and many others.

Overall, we are operating with a smaller field workforce than we were prepandemic, which is very reflective how the business model has changed as our online revenue has more than doubled from 2 years ago. We feel like we are largely at the right number as it relates to the strategic evolution of our operating model, the demand we are seeing and the nature of our customer interactions. What is most important right now is to continue to learn and iterate.

As you can imagine, having a more flexible workforce is a very important component of our operating with a smaller workforce. And technology is crucial to its success as well. In fact, technology is the underpinning to the success of our company strategy. We need technology tools and capabilities to help us as we transform and evolve the way we operate. This fact has been clearly reinforced by all of our pilots.

There are a myriad of technology projects in development, but here are just a few examples. We will leverage the electronic sign labels in our stores to make it simpler and more seamless for customers to shop, especially in our stores with smaller shopping square footage. Specifically, we are adding messaging to the labels that mimics our dot-com experience. In other words, customers will easily be able to see if the product is in stock in that store or in another store nearby and when it could be delivered and installed.

We are also piloting mobile app checkout so that customers, particularly grab-and-go customers, can quickly check out without needing to interact with an associate. For our virtual store to really come to life seamlessly for our customers, we are building out a new digital communication platform

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that will combine multiple systems into one experience for call, chat, video and screen sharing. This will quickly and seamlessly put our customers in control of how and when they want to be served across these vehicles.

Of course, we are also continuing to make significant investments in fundamental technology capabilities like data and analytics and broader cloud migration in order to drive scale, efficiency and effectiveness. Earlier this month, Fast Company named us to its 2021 list of the 100 Best Workplaces for Innovators. This is our first time on the list, which recognizes companies that created cultures of innovation despite the challenges posed by the pandemic.

During the quarter, we continued to expand our assortment in newer categories where we can leverage our ability to commercialize new technology. For example, in the past year, across fitness and wearables, wellness and health, we have more than doubled our vendor partners and grew our SKU count by more than 150%. These include new products important to our health strategy, specifically those focused on conditional health management that help customers track blood glucose levels, keep tabs on heart data, manage weight or even help identify allergens in foods. Furthermore, we are working with hospitals and care centers to curate health products for their patients on co-branded landing pages.

Because customers are looking to us to complete their solutions, we are also expanding to additional adjacent categories. For example, we have expanded our assortment in categories like outdoor living as more and more consumers look to makeover or upgrade their outdoor spaces. This includes products like patio furniture, grills, fire pits and electric mowers, to name a few. Many of these products are available online only as part of our digital-first strategy. Altogether, they are a small part of our overall business, but growing fast as we continue to add to the assortment. In the back half of the year, we expect to add more products in the fitness, beauty, sleep, pain management, vision, hearing and electric transportation categories.

Before I conclude my prepared remarks, I want to update you on our ongoing commitment to inclusion and diversity and our community. During the second quarter, we announced our commitment to spend at least $1.2 billion with BIPOC and diverse businesses by 2025. This pledge includes plans to increase all forms of spending with black, indigenous and people of color businesses from nearly every corner of the company from how we bring goods and services to stores to where and how we advertise. The goal is to create a stronger community of diverse suppliers and to help increase BIPOC representation in the tech industry.

In addition, earlier this month, we announced we are investing up to $10 million with Brown Venture Group, a venture capital firm that focuses exclusively on black, Latino and indigenous technology startups. The goal of this investment is to help break down the systemic barriers often faced by BIPOC entrepreneurs, including lack of access to funding and empowering the next tech generation.

To make a difference in our local communities, we are passionate about building out our Teen Tech Center program. These provide teens in disinvested communities access to the training, tools and mentorship needed to succeed in postsecondary opportunities and careers. We are also building a diverse talent pipeline for jobs of the future. During the second quarter, we launched our first-ever opportunity for customers to donate to the Best Buy Foundation in support of Teen Tech Centers. Between July 11 and September 11, customers can choose to donate when they make a purchase, including at Best Buy store, bestbuy.com or the Best Buy app. We also just published our 16th annual ESG report, which outlines how we are working across the company to have a positive impact on our planet, employees, customers and communities.

In terms of the environment, this past year, we exceeded our goal to reduce carbon emissions in our operations by 60% through investments in renewable energy and operational improvements. We are on track to reduce our carbon emissions 75% by 2030. And we signed the Climate Pledge, committed to be carbon neutral by 2040, a decade faster than our previous goal of 2050. We also have a robust trade-in program that brings a useful second life to products that might otherwise sit idle in someone's home or end up in a landfill. For products that need to be recycled, we continue to operate the most comprehensive consumer electronics and appliances take-back program in the U.S., taking back more than 2 billion pounds since 2009. Available on our corporate website, our ESG report also outlines the ways we support our employees and communities.

In summary, we have delivered a remarkable first half against a volatile backdrop. I am so proud of the execution of our teams as they continue to safely meet the needs of our customers in ways that I would argue no one else can. Based on the strength of the business and our expectations for continued customer demand, we are raising our sales outlook for the back half. Of course, the environment as it relates to the pandemic is still rapidly evolving, and there is uncertainty as to the associated impact on many important factors, including consumer shopping behavior, share of

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wallet on services like dining and travel, return to office and return to school. Furthermore, we continue to believe the holiday season will remain unique against that backdrop. That being said, our teams have proven they can and will continue to proactively navigate these factors, and they remain ready to respond and adjust the business as the environment potentially changes.

Over the longer term, we are fundamentally in a stronger position than we expected to be in just 2 years ago. There has been a dramatic and structural increase in the need for technology. And we now serve a much larger install base of consumer electronics with customers who have an elevated appetite to upgrade due to constant technology innovation and needs that reflect permanent life changes like hybrid work and streaming entertainment content. This is only underscored by the recent Senate passage of the Infrastructure Bill, which will provide even more access to broadband and give us the opportunity to serve the needs of currently underserved communities. Our unique omnichannel assets, including our ability to inspire what is possible across the breadth of CE products as well as our ability to keep it all working together the way customers want, truly differentiate us going forward in this new landscape.

Now I would like to turn the call over to Matt for details on our results and insights on our outlook for the next quarter and the full year.

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Good morning, everyone. We are once again reporting very strong financial results as the demand for the products and services we provide remained high during the quarter. On Enterprise revenue of $11.8 billion, we delivered non-GAAP diluted earnings per share of $2.98, an increase of 74% versus last year. Our non-GAAP operating income rate of 6.9% increased 100 basis points. This rate expansion was driven by an 80-basis-point improvement in our gross profit rate. Despite lapping actions to reduce our SG&A spend last year, we were able to leverage our SG&A 20 basis points on the higher sales volume. In addition, a lower effective tax rate had a $0.47 favorable year-over-year impact on our non-GAAP diluted EPS. As a reminder, in Q2 of last year, our stores were closed to customer traffic for about half the quarter while we were helping customers through our curbside service and in-store appointments. We also made several cost-reduction decisions last year to align with the lower sales and channel trends we were seeing and expecting to continue at that point.

As Corie mentioned, when comparing our results against 2 years ago or the second quarter of our fiscal '20, total revenue grew more than 24%. Also, our Domestic store channel revenue was higher than 2 years ago despite almost 50 fewer stores and online revenue growth of almost 150% in that time frame. As a result of the higher revenue and adjusting our business model to a new customer shopping behavior, our Enterprise non-GAAP operating income rate was 290 basis points higher this quarter than the comparable quarter from 2 years ago.

Let me now share a few comments on how our Q2 performance compared to the outlook we shared on our last call. Enterprise comparable sales growth of 20% was above our estimate of approximately 17%. Our non-GAAP gross profit rate improved 80 basis points versus last year compared to our outlook of approximately flat. As Corie stated, this better-than-expected gross profit rate performance was primarily driven by a more favorable promotional environment. Lastly, non-GAAP SG&A dollars grew 18% compared to last year, which was slightly favorable to our outlook of approximately 20% growth.

Let me now share more details specific to our second quarter. In our Domestic segment, revenue for the quarter increased 21% to $11 billion. Our comparable sales growth was also 21% for the quarter. In recent quarters, our revenue growth has been lower than our comparable sales growth due to the loss of revenue from stores that were permanently closed in the past year. Although that was still true this quarter, that impact was partially offset by revenue growth from stores that were closed for remodel as a result of last year's unrest and fall outside of our comparable sales calculation.

As a reminder, our comparable sales calculation includes revenue from all stores that were temporarily closed or operating in our curbside-only operating model during the period. This year, we expect to close approximately 30 U.S. stores compared to roughly 20 closures in each of the last 2 years. Consistent with our previous practice, we will make every effort to retain the employees from the closing locations. From a monthly cadence perspective, the strongest sales growth was in May. As expected, July's monthly comp was the lowest of the quarter as we lapped the reopening of our stores in June of last year.

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Turning now to gross profit. The Domestic non-GAAP gross profit rate increased 90 basis points to 23.7%. The higher gross profit rate was driven by improved product margin rates, rate leverage from our supply chain costs and higher profit sharing revenue from our private label and co-branded credit card arrangement. Overall, the promotional mix and sales discounts for the full quarter were once again lower than the levels we experienced last year. However, our comparisons are now beginning to lap periods of very low promotional activity last year. In July, the overall promotional activity increased versus last year, but was still below the levels we experienced during fiscal '20.

Moving next to SG&A. Domestic non-GAAP SG&A increased 19% compared to last year and decreased 30 basis points as a percentage of revenue. As expected, the largest drivers of the expense increase versus last year were: first, higher incentive compensation for corporate and field employees of approximately $100 million, which is partially due to the suspension of our short-term incentive program last year; second, higher store payroll costs due to changes in our operating model last year; and third, the impact of lapping our COVID-related impacts last year that resulted in higher cost this year for advertising expense, medical claims expense and our 401(k) company match. Lastly, we increased investments this year in support of our technology initiatives.

When comparing to 2 years ago, Domestic non-GAAP SG&A increased $94 million and decreased 310 basis points as a percentage of revenue. The largest drivers of the increase versus fiscal '20 were higher incentive compensation, technology investments and increased variable costs due to the higher sales volume. Partially offsetting these items was lower store payroll expense. On a non-GAAP basis, the effective tax rate was 8.4% versus 23% last year. The lower Q2 fiscal '22 rate was primarily due to a multijurisdiction, multiyear noncash benefit from the resolution of certain discrete tax matters.

Moving to the balance sheet. We ended the quarter with $4.3 billion in cash. At the end of Q2, our inventory balance was 55% higher than last year's comparable period and was 23% higher than our Q2 ending inventory balance from 2 years ago. The increased inventory represents our plans to support the current demand for technology as well as last year's unusually low inventory balance. The health of our inventory remains very strong.

Let me next share more color on our outlook for the second half of fiscal '22 and our updated assumptions for the full year. As we entered the year, we expected revenue growth to be positive in the first half of the year and then negative in the back half as we lap the strong comp growth in Q3 and Q4 of fiscal '21. Our original outlook also reflected a scenario in which customers would resume or accelerate spend in areas that were slowed during the pandemic, such as travel and dining out.

Although we are seeing some shift in consumer spending occur, the impact has been less pronounced than we previously anticipated. We now expect our comparable sales growth to be down 3% to flat to last year in the back half, which is a significant improvement from the high single-digit decline we expected entering the year. Like other companies, we continue to monitor the evolving impacts of the pandemic and supply chain pressures driven by global demand.

We continue to be confident in our ability to navigate the ever-changing environment. For the second half of the year, we expect non-GAAP gross profit rate to be down approximately 30 basis points to last year, which compares to 60 basis points of expansion in the first half of the year. The primary drivers of the sequential decrease include the impact of rolling out Total Tech, increased promotional activity and less leverage on our supply chain costs than we experienced in the first half of this year. The gross profit rate pressure of our new membership offering primarily relates to the incremental customer benefits and the associated costs compared to our previous Total Tech Support offer. This pressure is expected to have a larger impact to our fourth quarter than in the third quarter.

Now I will provide some color specific to our outlook for the third quarter. We expect comparable sales to be in the range of down 3% to down 1% to last year, which is on top of our 23% comparable sales growth in the third quarter of last year. Our revenue growth to start this quarter has been approximately flat to last year for the first 3 weeks. From a gross profit rate perspective, we are planning for a non-GAAP rate that is approximately 30 basis points below last year's rate. From a non-GAAP SG&A standpoint, we are planning dollars to be approximately flat compared to last year as we expect the lapping of last year's -- as we expect the lapping of last year's $40 million donation to the Best Buy Foundation and lower incentive compensation to be largely offset by increased technology investments and higher advertising expense.

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Turning to our full year outlook. We expect the following: Enterprise revenue in the range of $51 billion to $52 billion, comparable sales growth of 9% to 11% and a non-GAAP gross profit rate slightly higher than last year. For SG&A, we expect growth of approximately 9%, which compares to the prior outlook of 6% to 7% growth. The increased expense is primarily due to higher store payroll costs and other variable items associated with the higher sales outlook. In addition, we expect the incentive compensation for the full year to increase by approximately $275 million or at the high end of our previously provided range. We expect our non-GAAP effective tax rate to be approximately 20%. We expect capital expenditures to be in the range of $800 million to $850 million. And lastly, we expect to spend at least $2.5 billion on share repurchases.

In closing, over the last 2 years, our teams have been -- have successfully adapted to various changes to our operating model and a dramatic shift in customer shopping behavior. We have seen a surge in reliance and demand for technology as our customers also adapt to their changing needs. The result is that we now expect our sales will surpass $51 billion this year. That is more than $7 billion of increased sales over a 2-year period. Thank you to all our employees for driving these amazing results.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll move on to our first question from Steven Forbes of Guggenheim Securities.

Steven Paul Forbes - *Guggenheim Securities, LLC, Research Division - Analyst*

I wanted to focus on the pricing and promotional environment. So maybe I'll just ask my 2 questions together. The first part, right, is as we think about the price increases that are being passed through here to the consumer, can you sort of provide some context around the magnitude of them and how the industry as a whole is sort of addressing these, right? Is everyone sort of passing them through? Or do you see potential increases in promotional activity?

And then the follow-up to that is, as we think about the holiday period, right, and in past years, right, other competitors utilizing the category to drive traffic during the holiday period, can you sort of talk about the expectation, right, for holiday as a whole as it relates to frequency and depth of promotional activity?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Why don't I start and then Corie can jump in. I think there are a few questions in there, right? Overall, what we're seeing was the first half of this year was less promotional, similar to the trends we experienced last year during the pandemic. As we -- as I said in my comments, we are starting to see us lap those periods of very low promotionality. As in July, we're actually seeing the mix of items on promotion and the discounts associated with promotions are actually higher than last year.

So we're starting to see a bit more return to a promotional level that's more than last year, but still higher than -- still less promotional than 2 years ago. And so we do see that increasing. And over that period of time where promotions have been lower, customers have been essentially paying higher prices because the costs -- we haven't been promoting as much. And so that's certainly part of the aspect.

Also within pricing, we certainly are seeing a little bit of inflation as well as you look at the prices of the goods. And in some cases, those are being passed on to consumers. Appliance is an example where there has been increases to the cost of those goods, which the industry is generally passing on. But overall, inflation hasn't been a bigger part of our ASP increases. It's been more on the promotionality versus inflation that's been relatively small, impacting in the first half. It might be a little bit more in the back half, but I wouldn't expect inflation as it relates to pricing to be as significant.

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Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

And I would just simply underscore, our priority is always to be priced competitively, and that will be the case no matter what's coming through the costing side of things. And as we head into holiday specifically, to that part of your question, we said, even in the prepared remarks, we would expect the back half to be more promotional, and that alluded to July being a little bit of that lead into what we're seeing. And we would expect the products that we sell to be products that people really want for holiday, and therefore, that environment to heat up correspondingly. And so that is part of what's embedded in the guide going forward.

Operator

We will now move on to our next question from Peter Keith of Piper Sandler.

Peter Jacob Keith - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Great results here. I was hoping you could flesh out a little more on the membership program. It seems interesting. I guess for the same price, it's basically an upgraded Total Tech Support. Can you confirm that's going to all stores by year-end? And then with the gross margin pressure you're experiencing, is that something that will be ongoing? Or is it more of an annualized effect as the program gets ramped up?

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Thank you, Peter. I'll start, and then Matt can talk a little bit about financial ramifications. So what was important to us in Beta was understanding how can we build on some of what we're learning in Total Tech Support in terms of what our customers love, but add on to that what we think will continue to provide them value over time.

Like many membership programs, ours is continuing to evolve based on what we are learning distinctly from our customers. And so we started testing Beta actually just at the very beginning of this fiscal year. And as we said in the prepared remarks, we're definitely seeing an uptake that is greater than both what we expected, greater than what we were seeing in Total Tech Support. And I think it's this combination of features that we talked about in the prepared remarks that are making our customers come to us more frequently and like we also said, spend a bit more each time that they're coming to see us, because you have this combination that keeps customers very sticky to the Best Buy brand.

And so this is really an evolution of what we have learned in Total Tech Support, started testing in the very beginning of this year, and then we plan to actually roll out toward the end of Q3. So it will be in place, like Matt said, have a bigger impact for Q4. But the key for us is that we expect the membership to grow faster than what we saw in TTS, and we've seen it play out in the pilot. And we're going to keep iterating on the offers, frankly, depending on what it is that customers really value and what it is that keeps them loving our brand and very loyal to the brand. I'll let Matt talk a little bit about the financial implications.

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Thank you. Thanks for the question, Peter. Essentially, as you would imagine, the Total Tech offer is just far more inclusive to -- benefits to our customers. And so with that, we're seeing more costs associated with Total Tech. It just has more enhanced benefits than what we had offered in TTS, and that is essentially driving the gross margin profit route, gross margin impact in the back half of this year.

The intent of Total Tech is not to actually drive margin rate. The intent of Total Tech is for us to increase sales and therefore, leverage more sales into the future. So the short-term impact certainly is going to be a gross profit rate impact. As you look forward, the intent is for not to be gross profit accretive, because what we want people to do is to use it more.

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That usage will create more sales and create more leverage on our bottom line in the future, and that's kind of the Total Tech. But as you would imagine, the enhanced benefits do come with more costs, but we believe that will keep people stickier and coming back and increase our share of wallet with them.

Operator

We'll now move on to our next question from Michael Lasser of UBS.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

Your guidance now includes the expectations that your comps are going to be flat to down in the second half of this year versus last year. You previously assumed that we're going to be more like downsizing or we'd get -- it sounds like the difference being that consumers have yet to really shift their wallet to the categories that you expected.

Do you think this reflects some permanent change in behavior? Or it's going to happen, it's just that it's not going to happen in the second half of the year and it's going to be more like a 2022 event?

And within that, can you also give us an indication of how you factored in any sort of composition of your inventory in the back half? Meaning while it's up significantly overall, are there any areas where you might be a little short on inventory that would lead to some out of stocks and you factor that into the slightly down 3%.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

So I will start, particularly on the wallet shift question. We noted in the prepared remarks that we definitely are seeing that shift happens slower than what we thought. And it's less than a shift. It's actually been -- for a while, we're seeing growth in both sides. And as Matt said, as the pandemic has kind of redoubled its efforts, we've seen it shifting away a little bit from some of the experiences. But we've just seen this growth continue, honestly, in both experiences and on the retail side.

I think we're pragmatic. And we've said in the prepared remarks, we believe at some point, that shift will continue to happen. I think it is being pushed out a bit. But importantly, there are also systemic changes that have happened in the way that all of us live, right? If you think about something like hybrid work models, that's not just something that's going to happen in the back half or in a quarter. That is likely a new way of working going forward.

Or streaming and the amount of streaming content, that's not just an in-the-moment change. That is a change in how people will consume content going forward. And so I think, honestly, you have a little bit of both sides here. You have real systemic changes that happened have in the way that we live. And there's, I think, been a pushout in people really shifting hard that spending to experiences. And then part of that, just being how healthy the consumer is in terms of sales, savings rates that are at all-time highs and very healthy balance sheet, access to credit. And all of those fundamentals being really solid, I think, is helping buoy this demand across both experiences and retail.

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes. And I'll just add a little bit. Corie did a great job explaining the consumer side of that. I think overall, as you talked about, we are now expecting flat to down 3% in the back half. And that's much better than we had expected at the end of last quarter, which was more closer to down approximately 8%. I think one of the things I would add to that situation is inventory. We feel like we're in a good spot as we look at the back half of this year. I think you asked about inventory. We are still seeing pockets of inventory. But quite honestly, we're in a really healthy strong position and are preparing ourselves very, very, very well for the holiday season. So that clearly adds to our optimism to the back half as well. There are still a lot of uncertainties as we look at it, but we'll update people as we go.

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Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

And my follow-up question is on the promotional environment and gross margin. You mentioned that in July, you saw promotions higher than they were in 2020, but still down from where they were in 2019. So how have you factored in your gross margin expectation for the next couple of quarters, where the promotional environment is going to be? Will it still be higher than or below 2019? And under what conditions could you see some of the other players in the space start to become more promotional than they were in 2019, especially if sales really start to flow at a greater rate than you're expecting?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes. I think overall, we're always going to be very aware of what our competitors are doing in the back half, whether it's back-to-school or the holiday season. So we'll always be prepared to adjust as appropriately. We are very thoughtful about how we compete and where we compete in being thoughtful managers of the P&L, if you will.

But overall, I would say, the promotionality, we would say probably a little bit higher than what we experienced last year or fiscal '21, but still less promotional than we saw in fiscal '20 starting right now. Again, we'll look at that and manage it as it comes and as we see the holiday unfold a little bit, but -- because we will fundamentally always be competitive. But I think generally, we'll be more promotional than last year, probably less promotional than 2 years ago.

Operator

We'll now take our next question from Karen Short of Barclays.

Karen Fiona Short - *Barclays Bank PLC, Research Division - Research Analyst*

Just a couple of questions to clarify. First of all, on the gross margin. So it's fair to say that with respect to the rollout of Best Buy Total Tech that, that will pressure gross margins from -- through 1 -- through 3Q of next year? That's just a clarification.

And then my bigger picture question was when you think about the overall higher install base of consumer electronics since this pandemic began, wondering if you could give a little color on how you see, actually see the acceleration in the innovation cycle playing out? Meaning, obviously, we'll have shorter and shorter life cycles, leading to the need to upgrade more frequently, but wondering if you could just contextualize that a little bit.

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Thanks for the question, Karen. Yes, I'll start and then Corie can jump in on the last part of the question. We're not ready to guide next year yet, but certainly, we are expecting Total Tech to pressure Q3 of this year and Q4 of this year as we roll it out. As you can appreciate, we're still trying to understand usage at a rollout level. And so it's a little early for us to talk about where how long that pressure will exist and in what line of the P&L.

As I said, the goal is for it not to actually be accretive to margins. It's supposed to be used and what that usage will come more cost. But overall, we do expect it to grow our sales over the long term and increase our -- improve our experience and increase that wallet share. So it's a bit early to tell how that impacts next year, but we'll obviously update people as we learn more.

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Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

On the question of installed base, it's my favorite question. We definitely are seeing more penetration of consumer electronics. And in many cases, it's because people have consumer electronics for multiple locations and use cases in their lives, right? In the hybrid work model, I might have one set up at home. I might have one set up at work. I might even have one set up for on the go. And so you've seen this deeper penetration than ever into people's homes and lives.

What's interesting about that is you hit on in terms of innovation. I mean obviously, you've got some of the world's largest companies that have both benefited from that deeper penetration, but also, of course, are going to continue to innovate in a way that will inspire customers to replace. And we're definitely seeing, to your point, those replacement cycles condensing down as new attributes are coming online that are really useful to people.

I mean if you think about the evolution of just cameras in computers over the last year because so many people are using video, now you've got cameras that track you even in tablets. And so there's just going to be this constant drive to be the next new interesting features and attributes that you add to products. And really what's fascinating is based on survey data that we're looking at right now, intent to purchase still remains very high in the next 12-month window, which to us says you've got people who already are trying to think about what might be that next product, either add-on or upgrade that's going to help me live through maybe another year of on and off at-home schooling or another extended period of working from home.

And so while these are really difficult numbers to get our arms around in terms of upgrade frequency, we are, for sure, seeing a customer that more and more often is looking for those new attributes. And then importantly, vendor partners who are really working hard to create that next suite of solutions that will kind of solve what we just talked about as being really fundamental structural changes in how we're living our lives.

Operator

We now move on to our next question from Brad Thomas of KeyBanc Capital Markets.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

Great quarter. I was hoping you'd talk a little bit more about the outlook for comps as you think about categories. Obviously, in 2Q, very strong results on a 1- and 2-year basis across the board. With comps having slowed a bit in the guidance for results to be declining in the quarters ahead here, how are you thinking about the categories that are going to be strongest and weakest?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes. I think there's a lot of categories that will continue to see opportunities and growth in the back half of the year. Obviously, there's -- gaming could be an opportunity as you look at the last 6 months of this year, depending upon the levels of inventory that we receive. Appliances has been a category, both large and small, have been growing for years at a time. So we do see more opportunities there.

And clearly, a home theater has opportunities as it always does in the back half of the year, especially over the holiday season. So those are some of the bigger ones. I'd say computing might be an area where it might be a little -- it might be slow based on the immense demand that it's had over the last several years going back. But there are a number of categories that will continue to grow.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

I think you likely also have some new category and new product introductions, both the new categories that we talked about that we're expanding into, while not as big, definitely provide some growth opportunity as well as likely some new product launches here in the back half that always stimulate back to the question about constant innovation that always stimulate a little bit of demand as well.

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Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

Great. And Corie, if I could follow up with a longer-term question about health care. I was wondering if you could just give us an update on how optimistic you're feeling about that growth initiative going forward. You did mention partnerships with hospitals and care centers that you're working on. But how are you feeling today versus the Analyst Day a couple of years ago in terms of the growth opportunity in health care?

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Yes. So just as a reminder, there are 3 main aspects to our health care strategy. The first is the consumer health category. We talked a lot about that today, which is how you monitor a chronic conditions such as diabetes or heart disease and expanding our assortment of health care products in the way that only we can when it comes to commercializing new technology.

The second area is active aging, which is all about emergency response, device-based tools that can help those who wish to live independently in their homes. And that builds on some of the acquisitions that we've already seen.

And then the third, which is a little bit more nascent, is virtual care. And that includes digital health caring center services that can connect patients and physicians to enable virtual care and remote patient monitoring. That was the most nascent, and that one will take the longest to develop.

The first 2, we remain really bullish. And you can hear even in our prepared remarks, the amount of devices that are proliferating right now to help people manage their own care is absolutely incredible. And so on the consumer side, we feel really strong as well as the active aging side, where we're starting to see that business rebound especially as we're starting to more people come back into our stores. And I think the appetite, as you think about virtual care, especially given the last 18 months that we've all gone through and that ability to not always rely on an in-person hospital visit, but instead be able to monitor some of your vitals, I think, obviously, there's an even greater use case now than there was 18 months ago.

So when I put all of that together, I think broadly, we remain really optimistic about how the future of health care can be changed through technology and the role that we can play in that.

Operator

We will now move on to our next question from Scott Mushkin of R5 Capital.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

I had 2, and one was just trying to get my arms a little bit better around that fourth quarter and what it might look like from an inventory perspective, from a margin perspective, and from an inflation perspective. It just seems -- and the fourth quarter is always a challenge. I was wondering if you could give us a little bit more maybe what you're thinking there? And then I had a longer-term question as well, and I'll start there.

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes. Thanks, Scott. I think I'll start and Corie might need to jump on the last part there. I think overall, for the Q4, we were very confident that we are going to have inventory to meet and support the demand of our customers. There's always a level of constrained inventory when you get into Q4. We are still seeing pockets of constraint now. We are in a very healthy inventory position. Clearly, we'd like to have more in certain areas. But we have a high degree, as we've talked about, transferability between categories and within category assortment to meet customers' demands. So we're feeling good there.

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I think overall, from a gross profit perspective or a profit perspective, one of the -- we did talk about how we expect to see gross profit rate pressure in Q4. Total Tech is certainly the bigger part of that pressure. We will see probably more return to more promotionality compared to last year. But again, overall, compared to 2 years ago, it should be less. But again, we'll watch and see where it goes and adjust accordingly.

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

Terrific. I appreciate the color. And then my second question is what you guys talked about with the holistic market approach down in Charlotte. Again, just looking for a little bit -- maybe a little bit more detail. Are you guys going to be remodeling all the stores? How many stores do you have down there? When will it be complete? Just any more details around that. That sounds very exciting.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Yes. I am excited about what we're working on in Charlotte because I think it uniquely leverages all of our assets across both our physical assets, our stores. And for the most part, we aren't touching every single store. There will be a number of remodels, but it's not every single one. But it also leverages our unique people assets, our consultants, the designers and advisers in our stores and leverage them across, not just like conventional store footprint, but also in places like an outlet or in places like an auto tech mega hub, which might have or 8 or 10 auto bays where you can work on all the cars together as an example.

And we said in the call, I think it's going to take a couple of quarters for us to roll everything out in the market. And then obviously, there still are operating model changes that go with that as you learn how to more flexibly operate all of these models. But the goal for us is balancing -- this isn't just about like quantity of stores. This is about what you want each of your footprint to do for you, and then the operating model and the people flexibly working around that physical footprint in a way that uniquely provides customers, both that inspiration and support that we offer that really no one else can.

And so I think this is our very best foot forward, not just on one concept, but trying to put all the concepts together and say, "If I want to serve a market, how might I help a customer navigate different Best Buy experiences and also help our employees work more flexibly across all those experiences."

Scott Andrew Mushkin - *R5 Capital LLC - Founder, Managing Partner, CEO & Director of Research*

Perfect. I just want to say, you guys -- I was going to say you guys do an incredible job given what's been thrown at you. So nice work.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Thank you very much. That means a lot. So I just want to close by saying thank you again to all of our amazing associates, and thank you all so much for joining us today. We look forward to updating you on our results and our progress during our next call coming up in November. Have a great day.

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