Q3 2023 Earnings Call

Company Participants

- Hector Padilla, Executive Vice President - Outside Sales & Service
- Isabel Janci, Vice President, Investor Relations and Treasurer
- Jeff Kinnaird, Executive Vice President, Merchandising
- Jordan Broggi, President, Online
- Richard Mcphail, Chief Financial Officer & Executive Vice President
- Ted Decker, President and Chief Executive Officer

Other Participants

- Brian Nagel
- Chris Horvers
- Chuck Grom
- David Bellinger
- Michael Lasser
- Mike Baker
- Scot Ciccarelli
- Simeon Gutman
- Steve Forbes
- Steven Zaccone
- Zachary Fadem

Presentation

Operator

Greetings, and welcome to The Home Depot's Third Quarter 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. (Operator Instructions) As a reminder, this conference is being recorded.

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

Isabel Janci {BIO 16473072 <GO>}

Thank you, Christen. And good morning, everyone. Welcome to Home Depot's third quarter 2022 earnings call. Joining us on our call today are Ted Decker, Chair, President, and CEO; Jeff Kinnaird, Executive Vice President of Merchandising; 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 and 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 includes 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 filing 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 {BIO 16614891 <GO>}

Thank you, Isabel. And good morning, everyone. We appreciate you joining us on our call this morning. Sales for the third quarter were $38.9 billion, up 5.6% from the same period last year. Comp sales were up 4.3% from the same period last year, and our U.S. stores had positive comments of 4.5%. Diluted earnings per share were $4.24 in the third quarter compared to $3.92 in the third quarter of last year.

From a geographical perspective, each of our 19 U.S. regions delivered positive comps versus last year, while Mexico posted comps above the company average, and Canada below the company average, both in local currency.

The team has done a fantastic job serving our customers, while continuing to navigate global supply chain disruptions, inflation, and a tight labor market. This quarter also marked another active hurricane season. As they always do, our associates and suppliers did an incredible job supporting those in the path of both Hurricanes Fiona and Ian, and our thoughts continue to be with those impacted by these storms.

Our results in the quarter reflect continued solid demand for home improvement projects. While we did see some deceleration in certain products and categories, as Jeff will detail, the project business remains strong across most of our departments. We also saw year-over-year growth with both our Pro and DIY customers in the quarter

While the business performed very well, and our consumer remains resilient, we are navigating a unique environment. We can't predict how the evolving macroeconomic backdrop will impact our customer going forward. However, we continue to closely monitor elasticities and trends across our business, and believe we

have the tools, team, and the experience to effectively manage in any environment.

Despite near-term uncertainties, we believe the long-term underpinnings of demand for home improvement remain strong, and that we are well positioned to leverage our distinct competitive advantages to capitalize on compelling growth opportunities in our space.

We are pleased with the traction we are seeing in our interconnected business, as we continue to build on our momentum with both our Pro and DIY customers. For example, as we add better functionality and capabilities in our Home Depot app, we see greater engagement. In fact, throughout the year, we have seen strong double-digit growth in monthly active users versus last year.

The growth is attributable to several enhancements we have made, including an improved online experience for our Pro loyalty program, the seamless connectivity we've provided for our military program, and the launch of our new store mode feature, which makes navigating the store and interacting with products much easier. These enhancements translate to less friction for our customers, as they navigate the digital world and connect to the physical world.

We also remain focused on driving continuous improvement and productivity within the four walls of our store to enhance both the associate and customer experience. We are currently launching a new application on our in-store mobile devices called Sidekick, which is an in-aisle tasking tool designed to direct associates to the highest value tasks in real-time. The tool will direct associates to key bays where on-shelf availability is low or outs exist. By simplifying our operations, we can generate productivity and enhance both the customer and associate experience.

For the Pro customer, we remain focused on investing in an ecosystem of capabilities, including enhanced fulfillment, a more personalized online experience, as well as other business management tools to drive deeper engagement with these customers. While we are focused on removing friction from the shopping experience, we are also onboarding capabilities to help our Pros run their businesses more efficiently.

Our Pros tell us that finding qualified, skilled labor is a pain point in their business. To that end, we recently announced our Path to Pro platform, connecting skilled tradespeople with hiring trades professionals. This unique and proprietary platform is available at no cost to all Pro Xtra members. It already contains thousands of candidates, and pros have begun posting their open jobs.

Our team remains focused 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. I'd like to close by thanking them for their dedication and hard work.

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

Jeff Kinnaird {BIO 19649706 <GO>}

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. As you've heard from Ted, during the third quarter, we continued to see solid demand for home improvement projects and strong execution from our teams and supplier partners.

Turning to our comp performance during the third quarter, 11 of our 14 merchandising departments posted positive comps. Building materials, plumbing, lumber, millwork, paint and hardware had comps above the company average. All other departments, with the exception of appliances, flooring, and indoor garden, were positive, but below the company average. During the third quarter, our comp average ticket increased 8.8%, and comp transactions decreased 4.4%. The growth in our comp average ticket was driven primarily by inflation across our product categories as well as demand for new and innovative products.

Inflation from core commodity categories positively impacted our average ticket growth by approximately 200 basis points during the third quarter, driven by inflation in building materials, lumber, and copper. Big ticket comp transactions or those over $1,000, were up 10.1% compared to the third quarter of last year. We saw big ticket strength across many Pro heavy categories like fasteners, pipe and fittings, and gypsum. During the third quarter, both Pro and DIY sales growth was positive, with Pro outpacing DIY. We're encouraged by the continued momentum we are seeing with both our Pro and DIY customers. In addition, our Pros tell us their backlogs remain strong.

During the quarter our project business remained healthy. This can be seen in the double-digit comp performance of our building materials, plumbing, lumber and millwork departments, as well as in other categories like fencing, siding, conduit boxes & fittings, tubs & showers, and cabinets. We are also encouraged by the momentum we continue to see with our larger Pro customers. These medium to large repair & remodeler Pros continued to post strong double-digit comps.

We believe we are building a unique, interconnected Pro ecosystem that will increase our ability to grow share in a $450 billion dollar addressable Pro space. To serve the Pro, it's about removing friction through a multitude of enhanced product offerings and capabilities. We feel confident that the investments across our Pro ecosystem are resonating, and that we continue to gain share with this important customer.

As you know, we have been on a journey to remove friction from our interconnected shopping experience. A

great example of this was our announcement in December of 2017 to own more of the appliance delivery end-to-end. And in the third quarter, we achieved an important milestone, we now have 100% of our appliance delivery volume managed through our market delivery operations. This has significantly improved the customer experience. On time and complete deliveries have increased meaningfully, and customer satisfaction metrics have increased by approximately 6 percentage points compared to the third quarter of last year.

Turning to total company online sales. We are very pleased with the performance of our digital assets. Sales leveraging our digital platforms increased nearly 10% compared to the third quarter of last year. This was driven by our continued investments which are resonating with our customers. For example, during the quarter, lead times improved across different fulfillment capabilities, which drove greater conversion.

For those customers that chose to transact with us online during the third quarter, approximately 50% of our online orders were fulfilled through our stores, a testament to the power of our interconnected retail strategy. We are excited about the holiday season. During the third quarter, we hosted our Halloween event and could not be happier with the results. 2022 was a record sales year for our Halloween program both in-store and online, as our customers continue to add to their collection with our unique and exclusive assortment.

As we turn our attention to the fourth quarter, we intend to continue this momentum with our annual holiday, Black Friday, and Gift Center events. Our teams have sourced the most compelling artificial tree assortment we have ever had, which makes it easier for our customers to find the perfect tree for their Holiday. In terms of our decorative holiday program, we couldn't be happier with our industry-leading assortment with extraordinary features and functionality that looks great and also reflect exceptional value.

In our Gift Center, we continue to lean into brands that matter most for our customers, with our assortment of Milwaukee, Ryobi, Makita, DeWalt, Ridgid, Husky and more. Earlier this fall, we launched the next generation of the Milwaukee Drill and Drive M18 Fuel line-up offering more power, runtime, and increased safety for our customers. In our Gift Center, we are featuring this innovation in combo kits with four tools and two tools. And we have our exclusive Ridgid four tool 18 volt brushless combination kit, with two free tools, all backed by our lifetime service agreement.

And in appliances, we have exciting offers on LG, Samsung, Bosch, Whirlpool, GE, and Frigidaire. We have multiple exclusive offers including the LG side-by-side refrigerator with craft ice, a great innovation in ice

making.

As with prior years, we've extended these events over several weeks. And we believe we are well positioned with the right brands, the right inventory and a great customer experience. With that, I'd like to turn the call over to Richard.

Richard Mcphail {BIO 19175260 <GO>}

Thank you, Jeff. And good morning, everyone.

In the third quarter, total sales were $38.9 billion, an increase of $2.1 billion or 5.6% from last year. During the third quarter, our total company comps were positive 4.3%. The positive comps were 7.1% in August, 4.4% in September, and 2.1% in October. Comps in the U.S. were positive 4.5% for the quarter, with positives comps of 7.2% in August, 4.2% in

September, and 2.5% in October. On a three year basis, monthly comps were consistent across the quarter.

In the third quarter, our gross margin was approximately 34%, a decrease of approximately 10 basis points from last year, primarily driven by supply chain investments. We continue to successfully offset significant transportation and product cost pressures, while maintaining our position as a customer's advocate for value.

During the third quarter, operating expense as a percent of sales decreased 18 basis points to 18.2%. Our operating expense performance was in line with our expectations, which reflected continued wage investments as well as planned investments designed to drive efficiency in our store environment.

Our operating margin for the third quarter was 15.8% compared to 15.7% in the third quarter of 2021.

Interest and other expense for the third quarter increased by $80 million to $406 million due primarily to higher long-term debt levels than one year ago.

In the third quarter, our effective tax rate was 24.4%, down from 24.5% in the third quarter of fiscal 2021.

Our diluted earnings per share for the third quarter were $4.24, an increase of 8.2% compared to the third quarter of 2021.

During the third quarter, we opened three new stores, one in the U.S. and two in Mexico, bringing our total store count to 2,319. Retail selling square footage was approximately 241 million square feet.

At the end of the third quarter, inventories were $25.7 billion, up $5.1 billion compared to the third quarter of 2021. Inventory turns were 4.3x, down from 5.4x last year. And our inventory growth primarily reflects product cost inflation and strategic decisions in response to continued global supply chain disruption.

Turning to capital allocation, after investing our business and paying our dividend, it is our intent to return excess cash to shareholders in the form of share repurchases. During the third quarter, we invested $770 million back into our business in the form of capital expenditures.

And during the quarter, we paid approximately $1.9 billion in dividends to our shareholders, and we returned approximately $1.2 billion to shareholders in the form of share repurchases. Computed on the average of beginning and ending long-term debt and equity for the trailing 12-months, return on invested capital was approximately 43.3%, down from 43.9% in the third quarter of fiscal 2021.

Now, I will comment on our guidance for fiscal 2022. As you heard from Ted, we are very pleased with the solid performance we saw during the third quarter. Today, we are reaffirming our guidance for 2022. We expect comp sales growth of approximately 3% for fiscal 2022. We expect comp sales to be positive for the fourth quarter. We expect our fiscal 2022 operating margin to be approximately 15.4% for the year. And we expect mid-single-digit percentage growth and diluted earnings per share compared to fiscal 2021.

As we've said throughout the year, we find ourselves in a unique environment with many cross currents. We're operating in a broad-based inflationary environment not seen in four decades, while managing through constrained global supply chain conditions, all against a backdrop of monetary policy shifts intended to moderate demand. To-date, our customer has proven resilient. We feel confident that we'll continue to manage the flexibility through dynamic environment while growing faster than our market, and delivering exceptional shareholder value.

Before opening the call for questions, we are pleased to announce that we will be holding an Investor Conference on June 13, 2023, in New York City. We will share more details in the near future, but for now, please hold the date.

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

Questions And Answers

Operator

(Question And Answer)

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

Q - Michael Lasser {BIO 7266130 <GO>}

Good morning. Thanks a lot for taking my question. The sentiment and narrative around your stock is so heavily focused right now on factors that are out of The Home Depot's control, like the state of the housing market and its ultimate impact on home improvement demand. So, can you help frame what is in your control?

If home improvement demand, for example, was down 5% next year, is the state of your initiative such that Home Depot could gain a couple of hundred basis points of market share? And in that environment, you'd only be down, call it, 3%? And if your comps were only down 3%, given the flexibility that you have with your cost structure, coupled with your current capitalization that affords you to buy back a lot of stock, you could actually grow earnings in that sort of scenario.

A - Ted Decker {BIO 16614891 <GO>}

Hey. Good morning, Michael. Thanks for the question. A lot of detail there that, I won't get into specifics, but I assure you that we look forward to taking share in any environment.

There is a lot of noise around housing and home improvement. And you've heard some of this before, but if I can just step back a minute and lay out the environment the way we see it. I mean, we still feel very good, Michael, about our business. We just reported another strong quarter and reaffirmed our guidance for the year. And remember, we've grown this business $47 billion in the last two and three quarters year.

From our core customer, we think our customer is still healthy. I mean, our customer tends to have a good job, growing wages, strong balance sheets. They own their home and have seen increased home equity. However, as Richard said in his prepared notes, I mean, it is a unique environment, lots of crosscurrents, inflation and rising interest rates, et cetera. But given all that, our customer has remained resilient and engaged. As we said, both our Pro and DIY customers grew again in this past quarter. Project demand, in particular, is very strong. Our Pro sales are strong and our Pro intercepts with our customers indicate that their backlogs are still very healthy.

Customers are still spending lots of time at home. We're not all back at work five days a week, these homes

continue to age, and they're worth 40% more than they were pre-pandemic. Now, I'm sure we'll get into some housing questions; in housing, values may go down a bit, but we're still going to be up meaningfully on a two year basis.

We did see some deceleration in certain products and categories. And again, that's difficult to get at the root cause, is it a consumer pulling back in general? Is there a reaction to inflation? Do we have some pull-forward in certain categories that people bought so much of certain categories during the pandemic? Or are they moving on to other projects?

Our transactions have been stronger than initially thought with this inflation. I mean, that's why we have

raised guidance throughout the year, is that the price sensitivity wasn't as strong as we thought it would be. However, our guidance implies that fourth quarter comps will be the lowest for the year, albeit positive, and we have tougher comps from Q4 last year.

So with all of that as a backdrop, I mean, as I said in my comments, we believe we have the team, the strategy, the initiatives with each of our consumer and Pro that we'll continue to take share in any operating environment. And while there may be some of these crosscurrents in these next X quarters in housing, we still feel the backdrop of housing, the fundamental shortage of housing in this country and the aging of homes is incredibly strong for our space in the medium to long-term.

Q - Michael Lasser {BIO 7266130 <GO>}

That's a very helpful framework. But in light of some of the deceleration that you're seeing, one might assume that that might be a prelude to what could be a more pronounced deceleration into 2023, especially as some of the material benefit from inflation that The Home Depot has experienced this year fades. So is it best to recalibrate our expectations and think and model more about a negative comp in 2023 for The Home Depot, even if it's just slightly negative?

A - Ted Decker {BIO 16614891 <GO>}

Well, we'll talk about 2023 after our fourth quarter earnings call in February. Again, we remain incredibly bullish. There are certainly factors outside of our control. Are the Fed actions going to ultimately take us to a recession? If so, how deep that might be? Those are things that we're all wrestling with and everyone has an opinion. But we're focused on what we can control, rolling out our strategies, delighting our customers and taking share in any environment.

Q - Michael Lasser {BIO 7266130 <GO>}

Thank you very much. And have a great holiday.

A - Ted Decker {BIO 16614891 <GO>}

Thank you.

Operator

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

Q - Simeon Gutman {BIO 7528320 <GO>}

Good morning, everyone. Focusing on housing. So housing metrics are decelerating much quicker than your comps or your comp stacks. Is this just a lag effect? I don't know if this lag is longer than other lags or. And Ted, you just made the case that maybe sales decouple from these metrics. I assume it's temporary because of home equity, and we're spending more time in our home. Or are you suggesting that maybe it's not temporary because we're spending more time in our home?

A - Richard Mcphail {BIO 19175260 <GO>}

So Simeon, its Richard. Good morning. Just to maybe sort of put some further points on Ted's backdrop. A lot is made of home prices and home price appreciation, the change in home price appreciation, we think has always driven home improvement demand. And we've talked that with you for a long time. But what we also really ran into even, I'd call it the middle part of the last decade, was that as home prices begin to, call it, become more steady, price discovery in our view became a little bit harder.

And so the question has always been, number one, is there a lag to spending? Are you going to spend in that specific period when you know your home price has appreciated? Or is there a halo effect that lags over multiple periods? And our hypothesis is yes, that's what we saw in the last decade. And I think that that just sort of holds true from an intuitive perspective.

But I think there's another -- there are so many points that are important, and I think we are all somewhat anchored to what we observed in 2008 and 2009. And many of the folks on this call, in fact, almost all of us were here during 2008, 2009. You had a situation where 25% of homeowners were underwater on their mortgages. You had really a relationship that we saw in our comp sales driven by acceleration in foreclosures. So it wasn't -- we were not in a period of home price depreciation that you're talking about single-digits. We had a massive price correction in 2006 to 2008. There was price discovery every single day on the front of the newspaper and millions of forced sellers that were creating that price discovery.

When I look at the situation now, as Ted said, we have home price appreciation of essentially 40% year-over-year -- sorry, over the last three years. In fact, year-over-year home prices are up 13%. Since December, home

prices are up 8%. It is decelerating, but I think if you ask -- or if you listen to most observers, I think most people are calling for, if there is a correction, a modest one.

So my question is, how will the price discovery occur? And then second, is that price depreciation actually meaningful enough to change folks' spending behavior? Because as Ted said, if you're a homeowner, you've done quite well from a balance sheet perspective, you likely have a job, you likely have cash in the bank. And then we're seeing another just interesting dynamic where with mortgage rates increasing, our customer is becoming more and more likely to stay in place and begin a project. So improve in place.

And so just sort of going back to the health of the homeowner back in over a decade ago, 25% of mortgages were underwater back then. Let's look at the credit standing of the housing stock in the US now. Of owner-occupied households, 40% are owned outright, no mortgage. Of the 60% that do have a mortgage, 90% of

those mortgages are fixed rate. 73% of those mortgages are fixed rate below 4%. So we are now seeing a

dynamic of stay in place and improve your home. And that's what our customers are telling us, and that's what

the Pros are telling us their customers are telling them.

Q - Simeon Gutman {BIO 7528320 <GO>}

That's helpful. A follow-up on another very easy to forecast variable, inflation. Can you frame maybe may be what percentage of your sales could be at risk from disinflation? Is it 100 or it shouldn't be 100? Because some parts of your product mix aren't going to be vulnerable?

A - Jeff Kinnaird {BIO 19649706 <GO>}

Simeon, hi. Good morning. It's Jeff Kinnaird. We're watching inflation very carefully. We have seen some deceleration in inflation in the recent months, which is good for our consumers. But broadly, we are still experiencing some inflation in some specific categories. I'll call it the lumber market, we have seen a deflationary market in lumber over the recent weeks. In fact, we've seen a lot of stabilization in that industry versus the prior two years.

I did call out an impact from inflation in lumber for the quarter that was more representative of early days in the quarter. But we're looking at it carefully. We're managing category by category. We're working closely with our suppliers in terms of managing cost and cost components. We have a very good and deep understanding of virtually all cost components of all products that we sell. And again, we're managing it very closely.

Q - Simeon Gutman {BIO 7528320 <GO>}

Thanks very much.

Operator

Our next question comes from the line of Chris Horvers with JP Morgan. Please proceed with your question.

Q - Chris Horvers {BIO 7499419 <GO>}

Thanks. Good morning, everybody. So, maybe to summarize your comments today, I guess, it's that you are incrementally more cautious because you're seeing certain categories maybe become slowing or more volatile, but it's not dramatic and it's more of the uncertainty of what the Fed -- the Fed's rate raising is going to affect the business in the future potentially?

A - Ted Decker {BIO 16614891 <GO>}

Yes, I think that's a fair representation Chris.

Q - Chris Horvers {BIO 7499419 <GO>}

Okay. And then -- so can you talk about some of the KPIs you're watching, I guess, what categories specifically are concerning you? Are you seeing DIY trade down? Are you seeing maybe unit trends in the project business slowing? It seems like the commodity inflation is driving some of your best project categories. And are you seeing a more sort of volatility from the consumer, I guess, over the past couple of months that is adding that element of caution?

A - Ted Decker {BIO 16614891 <GO>}

Well, I would say, the healthiest thing we see, and as you can imagine, we look at every data set and by geography and category, et cetera. The healthiest thing about the business is the project nature of the demand. We are a project-oriented business. And all the categories that Jeff called out that is driving that project demand remains incredibly strong. And we look at it with both our Pro customers, household Pros versus consumers, and that project demand remains strong with each of the Pro and the consumer.

Some of the caution is -- and again, was it pull forward? Is that finally some price sensitivity on some of these whole good items. We've talked about certain appliance categories or grills, those definitely have come off the boil. And again, as everyone has purchased in the last three years a lot of those categories, and they've moved into more project and home improvement? Or is there a reaction to inflation? That's what's a little harder to chase out.

Here's a case in point. You look at our indoor garden business. Two big categories you might say are more discretionary, grills and patio. Grills was down, but patio, we had one of the strongest patio quarters that I can remember. So, there are definitely some mixed signals. It's definitely got our attention. And that's why we're cautious.

Q - Chris Horvers {BIO 7499419 <GO>}

And I guess just following up. You talked about consistent three year trends over the month. Obviously, October was an incredibly strong month last year. I guess, was that just -- we've heard a lot about the consumer shopping early last year, and the holiday season is normalizing. To what extent do you think maybe the election has had an impact on the business in November? And just overall, how are you thinking about the positioning today and then into the holiday season?

A - Jeff Kinnaird {BIO 19649706 <GO>}

This is Jeff Kinnaird. Look, we see some normalization back to 2019 in terms of the consumer trend. In the last couple of years, we've seen pull forward in concerns of supply chain-driven shortages across retail. So we do see potentially just the return back to more normal holiday spend by the consumer. As I commented in our prepared remarks, we feel very good about our Black Friday, our Gift Center, our decorative holiday assortments, and we're excited about the overall Black Friday season.

A - Richard Mcphail {BIO 19175260 <GO>}

And just in case you don't have the numbers in front of you, Chris, you called out monthly cadence. So really, our comps were consistent across the months, not just on three year but also on two year basis. Just keeping in mind that last year's comps in August, September and October were 3.1%, 4.5% and 9.9% sequentially. So, if you look at it on a two or three year basis, maybe smoothing some of that out. The one-year months don't tell you quite as much.

Q - Chris Horvers {BIO 7499419 <GO>}

Got it. That's very helpful. Thanks very much.

Operator

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

Q - Steven Zaccone {BIO 19950127 <GO>}

Good morning. Thanks for taking my questions, guys. Congrats on the strong results. To follow-up on Chris' commentary about the recent performance, has there been any impact from the hurricane recovery spend to call out maybe the end of the third quarter and thus far in 4Q?

A - Richard Mcphail {BIO 19175260 <GO>}

It was relatively minimal. So, we think we had about $120 billion impact from hurricanes this quarter. But keep in mind, we're overlapping a similar amount from last year. So, these hurricanes and storm impacts extend across quarters. What we're more concerned about is the health and safety of our customers and our associates, and our minds and hearts are certainly with them right now.

Q - Steven Zaccone {BIO 19950127 <GO>}

Okay. Thanks. A lot of discussion around the top-line outlook, given the housing uncertainty. But I wanted to focus on margin. I know there's not a target in place on a multi-year basis. But can you help us think through the levers to protect margin rate if sales growth were to weaken in the future? I guess specific to gross margin, is there an opportunity for gross margin rate improvement as supply chain costs ease?

A - Richard Mcphail {BIO 19175260 <GO>}

We're managing margin closely, Steven. We look at a quarter-on-quarter. There's a lot of ins and outs when it comes to margin as we look forward.

A - Jeff Kinnaird {BIO 19649706 <GO>}

We look at -- I'll just add that, we think we have the tools and the experience and the people to manage price and cost, as well and better than anyone else here. We've proven that. Over the last few years there has been immense disruption, right, in our value chain. And I think the proof is in the pudding when you look back at our history.

Q - Steven Zaccone {BIO 19950127 <GO>}

Great, thank you very much.

Operator

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

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Good morning, everyone. So I think everyone here kind of understands there's some uncertainty around the broader home improvement environment, given what's happening with interest rates. But how are you guys thinking about the growth potential prospects of the large Pro business as we roll out to 2023 because you guys will obviously have a lot more infrastructure and more relationships still at that stage?

A - Ted Decker {BIO 16614891 <GO>}

Thanks for the question, Scot. That -- I think we couldn't be more excited as we've identified a $450 billion addressable market. And an understanding of what capabilities we need to deliver to get a larger share of wallet with that large Pro repair remodeler. I've been here, as you may know, over 22 years, and we've always known what we needed to do to capture our share of wallet with that Pro.

And what's so exciting is that Hector and his team right now are actually building out the capability set to get more share of wallet with that large Pro. And as we build out these capabilities, introduce them to the customers, we're seeing the engagement and the incrementality of sales growth take off. And Hector, if you'd give us a little more insight of what you're building would be great.

A - Hector Padilla {BIO 19175124 <GO>}

Yeah, Scot, just we continue to be super excited about the response from our Pros as we continue to enable capabilities to remove friction from our ecosystem. Very excited about the expansion of our outside sales resources and the growth that those customers are driving. We're seeing those customers grow, not just with direct sales with our outside sales associates, but they're also engaging more on our digital platform and engaging more in our stores for that unplanned purchase.

And as we continue to grow around other capabilities, whether it's in the B2B digital platform, or in-store

platform, we just continue to be super excited about the response of our Pros. And we are just removing friction, we are removing friction from all the different channels, and our customers continue to engage with us more and more.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Is there a way to potentially size or at least for us to conceptually think about kind of what the potential revenue ramp is as these capabilities get build out?

A - Richard Mcphail {BIO 19175260 <GO>}

As Ted said, we're excited. One of the reasons we're so excited is because it's such a fragmented market, such a fragmented of suppliers. And so we just think the opportunity is exciting and tremendous, and part of the excitement is it's hard to size.

A - Ted Decker {BIO 16614891 <GO>}

But I can say, I mean, we don't break out these numbers, but each of Pro and consumer grew again this quarter. And the Pro yet again grew meaningfully faster than the consumer. And our large Pro, the ones who are engaging with Hector and team are developing, are growing the fastest yet.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Very helpful. Okay, thanks guys.

Operator

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

Q - Chuck Grom {BIO 3937478 <GO>}

Hey. Thanks. Good morning. Great quarter. Overall transaction is down a little over 4%. I was wondering if you could impact that for us across the Pro and DIY customer base.

A - Ted Decker {BIO 16614891 <GO>}

I don't know if we break that out, but the strongest, again, was the large Pro.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. All right. No problem.

A - Richard Mcphail {BIO 19175260 <GO>}

Look I'd say, I mean, the way to put it too, is our Pros shop across our assortment, so you're going to sort of see similar dynamics of ticket transactions across the business, generally speaking. But as Ted said, the strength is with Pro.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. Makes sense. And then on the cost pressure front, as costs start to ease, how do you think about the pricing environment? Do you think you and peers are likely to hold on to prices as costs start to moderate and you retain that margin as a result? Or are you likely to lower prices and try to maintain the same gross profit margin dollars?

A - Jeff Kinnaird {BIO 19649706 <GO>}

Chuck, we watch this very closely. We are the customer's advocate for value, and we watch the market and our competitors very closely. I will say that there has been an enormous shift to trading up to more innovation and more innovative products, we see that in our tool category, we see that in the outdoor garden business. We could see it across multiple categories, we still see that willingness to trade up for great value and a great innovation.

A - Ted Decker {BIO 16614891 <GO>}

And on the cost side, Chuck, it's definitely easing. So if you look at commodities, in particular, commodities have been down six, seven months in a row. Lumber is obviously way down from peaking at nearly $1,500 to now under $500 from peak to current during these last three years. However, we still see inflation across the store. So while some will be coming down in certain categories with costs and retails, our forecast at this point is that net inflationary cost pressures continue into 2023.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. Thank you.

Operator

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

Q - Brian Nagel {BIO 6638066 <GO>}

Hi, good morning. Nice quarter. Congrats.

A - Ted Decker {BIO 16614891 <GO>}

Thank you.

Q - Brian Nagel {BIO 6638066 <GO>}

So my first question, I just think I want to ask that Chuck's question maybe a little bit differently. But I mean, with regard to inflation, what we've seen now for a while is Home Depot has done a remarkable job kind of strategically pass along inflation. So Ted, you've mentioned a few times now you're starting to see some inflationary pressures ease.

Just the question I have is, are you seeing or would you expect that as inflationary pressures ease, even if pricing doesn't necessarily go down, you see some type of elasticity in demand meaning that unit demand would pick up in that type of environment?

A - Ted Decker {BIO 16614891 <GO>}

Well, it's a great question and you could say, hey, if elasticities weren't as sensitive on the up, would they also likely not be on the moderation, if you will? It's to be determined. I think, broadly, the price sensitivity wasn't as sharp as we expected over the last two years, that's why we started each year more or less a flat forecast expectation, and have beaten that each of the past two years.

On certain commodities, lumber, copper wire, where we're pricing to market weekly, you see a much more classic reaction to price and unit productivity. With other categories, and I hate to bring up grills again, but there's some classic price points on some plastic grills. And when we saw those grills get up over $600, we saw a more dramatic drop off in engagement. And when Jeff and the team work those prices down, even to the low 400s and or high 400s, low 500s, you saw a response with unit productivity.

Across the board, though, there has been -- and Jeff mentioned this, there has been so much innovation across our categories, if you think of the dramatic shift of outdoor power equipment in power tools, in appliances and what the features and benefits of these products are, the technology embedded in these products. I'm not sure it's quite an iPhone, but we're getting close to power tools being in that genre. And people love the newness and the innovation. And they are albeit higher prices, but people are responding in buying.

So I think it's a mix, Brian, across the categories. And that's what Jeff and our merchant teams do such a great job managing every day.

Q - Brian Nagel {BIO 6638066 <GO>}

Got it. It's very helpful. My follow-up and a quick one, just for Richard. You gave us the cadence of comps through the quarter, obviously, we saw the reiteration of guidance, but any commentary more specific on just the trended business here into Q4?

A - Richard Mcphail {BIO 19175260 <GO>}

Nothing in the first two weeks of Q4 changes our view on 2022 guidance. And as we said, we expect comps to be positive in the quarter.

Q - Brian Nagel {BIO 6638066 <GO>}

Got it. Appreciate it. Thank you.

Operator

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

Q - Zachary Fadem {BIO 18911015 <GO>}

Hi. Good morning. As you think about your DIY customers specifically and the well-documented challenges in the first half of the year, is it fair to say that your DIY customer improved on a one and three year basis this quarter? And as you think about consumer behavior in tighter economic and housing conditions ahead, is there a scenario where the DIY category outperforms Pro as customers trade down or maybe pull back on bigger projects?

A - Richard Mcphail {BIO 19175260 <GO>}

Zack, I may have to get you to repeat the second part of the question. On the first part of the question, look, we're really pleased with our consumer business through the year. Q1, we had what we always refer to as bathtub effect in some respects. And so we had a seasonal impact to consumer in Q1 of this year. Q2 and Q3 have both been positive, and we're very happy with that business. Could you -- would you mind repeating the second part of your question?

Q - Zachary Fadem {BIO 18911015 <GO>}

Yes. Is there a scenario where DIY outperforms Pro as customers trade down or pull back on bigger projects?

A - Richard Mcphail {BIO 19175260 <GO>}

Well, I don't think that there's an easy way to conjecture that. I do think that what we love about this business is, it's all end customer demand regardless of the channel that appears through. But we are -- we don't have a target Pro penetration for the business. And what we've seen through cycles is that, number one, we do very well with both. And you can see some fluctuation between the two. But really, what we have going right now is what we're observing, which is, the Pro business is leading the company that shows us that the demand for large projects is very healthy right now.

A - Ted Decker {BIO 16614891 <GO>}

And we -- someone asked this question before, I'm not sure we answered it. We are not seeing a trade down. If you take my grill or appliance example, it's not that people ultimately bought and they traded down. I think it's that people have already purchased in the past few years. And when people do purchase, again, they're buying innovation. Our Traeger business, for example, is incredibly strong, and as they bring out innovation, customers respond.

Q - Zachary Fadem {BIO 18911015 <GO>}

Got it. And when you think about your sixth straight quarter of transaction decline and the fact that there is a more stable repair and maintenance component of your business, to what extent do you believe we fully cycled away from all the pull-forward in excess discretionary category demand in 2020 and 2021? And when would you expect this to translate to a more normalized positive transaction cadence?

A - Ted Decker {BIO 16614891 <GO>}

Well, that's such a great question, and it's something we observe and build our theories of the case. When you go back now, what are we, we were 11 quarters of this pandemic. And the first five, six, we had tremendous transaction growth, right, we all know the story of what happened. Not necessarily a lot of cost inflation at that point. And then the last six quarters, we start to lap that tremendous activity. But also saw, for all the reasons we know, supply chain, commodities, global cost pressures, we saw significant cost in our business, and comps were driven as they were this past quarter with ticket over transactions.

What we see now is we step back approaching three years is our transaction run rate, our sort of three-year

CAGR at this point is more or less pre-pandemic rates. And you could look at that at one hand and say, wow, here's the slowdown. On the other hand, Richard, views the term holding serve, you can look and say, oh my gosh, this industry erupted with demand for a year and a half. Then it cycled significant cost increases. The customer hung in there and was resilient. And your net over this three-year period up in transactions and units despite, what we believe, you'll hold on to these price levels.

I think that all goes back to my opening comments of what is the dynamic of this overall industry and the health and the engagement level of this customer. And if we normalize from here, gosh, more than great. There's obviously all these questions about recession that we can't answer any better than you all can. But when you digest and look back on what's happened in the last three years, you'd say, wow, that's a pretty incredible market segment.

Q - Zachary Fadem {BIO 18911015 <GO>}

Appreciate the thoughts. Best of luck.

A - Ted Decker {BIO 16614891 <GO>}

Thank you.

Operator

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

Q - Mike Baker {BIO 4323774 <GO>}

Okay. Hi, thanks. Appreciate the color you gave on the fourth quarter outlook. But you've done such a great job improving your holiday business, in fact, in 10 of the last 13 years your fourth quarter comp has been better than your third quarter comp. And by definition, that's occurring on tougher comparisons. Can you talk about what you've done to make the fourth quarter such a bigger quarter for you? And why that might be different this year?

A - Jeff Kinnaird {BIO 19649706 <GO>}

Mike, Hey. It's Jeff. Yeah, we've had an exceptional fourth quarter. In the past year, we've built the business on the backs of decorative holiday. And we are the customer's advocate for value in that category, and we have great innovation and great -- again, great value for our customers.

Second, we've built the business of gifting in our Gift Centers. And you look at the innovation that we're delivering to our Pro and to our consumer, it's exceptional. I spoke earlier about the M18 Milwaukee drill and driver combo kit. The innovation is just exceptional, as Ted spoke to earlier. And then appliances. Appliances is an enormous category for The Home Depot. It's been a category that we've built at an incredible rate. We're investing in capabilities, like I spoke earlier, in terms of delivery. We're investing in dot-com capabilities in terms of our customers' willingness to review and purchase online.

Then I'd also say, we're building a great project and business in the fourth quarter. The fourth quarter is a great

time for a project. We see a lot of consumers painting, doing smaller projects around their home and getting ready for the holidays. And then finally, I'd say, storage -- storage and organization. We have an incredible storage event. We gain on the customer's advocate for value when it comes to storage across the business.

And then finally, we've built an incredible dot-com business. And this is -- we called out the performance in Q3. We're expecting a great Q4 with Cyber Monday. And a big part of that is our digital performance, our app performance. I've got Jordan Broggi here, our President of Online. Jordan, do you want to make a couple of

comments around the app?

A - Jordan Broggi {BIO 22265346 <GO>}

Yeah, sure. Yeah. Thanks, Jeff. I mean, as Ted called out at the front, the experience is where it -- what it's all about. We love the experience improvements we've made. A lot of it's around in-store connectivity. We talked about Store Mode, we talked about military, we talked about loyalty. We've got some features coming out on Pro for in-store checkout experience.

And our customers really respond. I mean, we love the ratings in the App Store, 4.8 with Apple, 4.7 with Google. But we see it in our numbers as well, strong double-digit performance and growth in downloads and MAUs, monthly average users. In our traffic, it's our fastest-growing online property. We're doing billions of

dollars of sales through the app. We couldn't be more excited.

Q - Mike Baker {BIO 4323774 <GO>}

Great. If I could ask one more follow-up, your buyback did slow a little bit this quarter. Is that may be a function of higher borrowing cost or how should we think about buybacks going forward? Thanks.

A - Ted Decker {BIO 16614891 <GO>}

We don't ascribe to necessarily a smooth cadence to buybacks. And that will typically reflect just sort of how we think about working capital investment through the year and a cash buffer throughout the year. So, there's really nothing to read into there.

Q - Mike Baker {BIO 4323774 <GO>}

Okay, thank you.

A - Ted Decker {BIO 16614891 <GO>}

You're welcome.

Operator

Our next question comes from the line of David Bellinger, with MKM Partners. Please proceed with your question.

Q - David Bellinger {BIO 18992350 <GO>}

Hey. Thanks for the question. So going back to some of the category comments. Are you seeing some evidence that the, call it, more discretionary items are turning lower and at a faster pace? I know last quarter you mentioned some of those higher ticket $300, $400 Halloween items being pretty much as discretionary as it gets and performing pretty well. We saw some discounts on those items in the weeks preceding Halloween. So, any indications that those splurge items are starting to cool off and more quickly than the rest of the business?

A - Jeff Kinnaird {BIO 19649706 <GO>}

David, we had -- as I commented earlier, we had record sales, both in-store and online in Halloween, that included the infamous Skelly, which has been one of our best sellers in terms of the innovation and value we offer our customers is really unmatched in the marketplace. And we couldn't be happier with our Halloween performance.

If I turn to the fourth quarter, we're really excited about our decor holiday assortment. We've got great innovation and great value for our customers across the assortment if it's trees, if it's light, if it's decorations, we feel very good about the category. And our consumers are reacting exceptionally well to it.

Q - David Bellinger {BIO 18992350 <GO>}

Got it. I have a Skelly, so I know exactly what you're talking about. My follow-up just on the inventory levels, how much of that growth is aimed at Pro customers? So, is there a piece of that inventory that's not sitting in the stores? Maybe it's at facilities like in Dallas so that the number looks to be a bit more elevated to us at the store level. Just help us unpack the 25% inventory growth number and just get us comfortable that you aren't sitting on too much at this point, especially with some of the deceleration you're now seeing.

A - Richard Mcphail {BIO 19175260 <GO>}

Well, so look investment in inventory in our One Supply Chain facility is certainly one of the factors in inventory growth year-over-year. But the primary factor is really just inflation as part of the inventory value. And then we made strategic decisions to land inventory earlier in the year than we have prior.

And really, just to give you some numbers around that and to reflect the fact, we feel fantastic about our inventory position. In Q2, we grew our inventory 38% year-over-year. In Q3, that number dropped to 27% year-over-year. And actually, if you look throughout our history, we actually typically build inventory from Q2 to Q3. In this case, our inventory actually came down by $400 million from Q2 to Q3. Our inventory is healthy, and we're happy with our position.

Q - David Bellinger {BIO 18992350 <GO>}

Thanks Richard. Appreciate it.

A - Richard Mcphail {BIO 19175260 <GO>}

Christine, we have time for one more question.

Operator

Thank you. Our final question will come from the line of Steven Forbes with Guggenheim. Please proceed with your question.

Q - Steve Forbes {BIO 16997307 <GO>}

Good morning. Maybe just a follow-up or focus on the quarterly performance. If I look at the press release, the selected sales data, obviously, excludes HD Supply. So curious, Ted, if you can expand on the performance of that asset in today's backdrop, as it looks like it may be driving some upside to the overall performance of the business.

A - Ted Decker {BIO 16614891 <GO>}

Yeah, Steven, thanks. Yeah, another great quarter for HD Supply. We mentioned this last quarter and they are just doing a terrific job. Shane O'Kelly and his team are running the largest and the best focused MRO business for multifamily housing and hospitality, extended living, et cetera. We are well -- we remain well ahead of all our financial projections, and we made the acquisition. Their integration is tracking, they're integrating sales forces, customer records, and now starting the work -- or are on their way in the work of integrating the supply chain. So that one has just been a terrific acquisition that we're super happy about.

Q - Steve Forbes {BIO 16997307 <GO>}

And then, maybe just a quick follow-up for Richard or Ted. Given the performance, can you remind us on what percentage of sales that business is today? And then as we look at the sort of spread between comp and that sales growth, any reason to think that the current sort of year-to-date spread doesn't hold into the fourth quarter?

A - Richard Mcphail {BIO 19175260 <GO>}

Well, we don't break HD Supply out. But as Ted said, we're so happy with it. On the difference between sales and comp, we've always seen a gap there. It just comp reflects sales, and the POS sales reflects sales as they're actually delivered or installed. You're going to see that number vary. Well probably, through the year, sales will be a little higher than the comp guide, but the important guide here is comp because that's our activity-based metric around sales.

Q - Steve Forbes {BIO 16997307 <GO>}

Thank you.

A - Richard Mcphail {BIO 19175260 <GO>}

Welcome.

Operator

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

A - Isabel Janci {BIO 16473072 <GO>}

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

Operator

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