The Home Depot, Inc. (NYSE:HD) Q4 2019 Results Earnings Conference Call February 25, 2020 9:00 AM ET

Company Participants

Isabel Janci - Vice President, IR

Craig Menear - Chairman, President and CEO

Ted Decker - Executive Vice President, Merchandising

Richard McPhail - Executive Vice President and CFO

Mark Holifield - Executive Vice President, Supply Chain And Product Development

Conference Call Participants

Michael Lasser - UBS

Scot Ciccarelli - RBC

Simeon Gutman - Morgan Stanley

Chuck Grom - Gordon Haskett

Christopher Horvers - J.P. Morgan

Michael Baker - Nomura

Karen Short - Barclays

Brian Nagel - Oppenheimer

Elizabeth Suzuki - Bank of America Merrill Lynch

Zach Fadem - Wells Fargo

Seth Sigman - Credit Suisse

Operator

Greetings. And welcome to The Home Depot Fourth Quarter 2019 Earnings 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

Thank you, and good morning, everyone. Joining us on our call today are Craig Menear, Chairman, CEO and President; Ted Decker, Executive Vice President of Merchandising; and 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 Craig, let me remind you that today’s press release and the presentations made by our executives include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995.

These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. These risks and uncertainties include, but are not limited to, the factors identified in the release and in our filings with the Securities and Exchange Commission.

Today’s presentations will also include certain non-GAAP measures. Reconciliation of these measures is provided on our website.

Now, let me turn the call over to Craig.

Craig Menear

Thank you, Isabel, and good morning, everyone. Fiscal 2019 was another record year for our business, as we achieved the highest sales in company history. Excluding the extra week in 2018, fiscal 2019 sales grew 3.5% to $110.2 billion. Diluted earnings per share were $10.25.

As expected, we finished the year with our strongest comp performance in the fourth quarter. Comp sales were up 5.2% from last year and our U.S. comps were positive 5.3%. Sales for the fourth quarter were $25.8 billion and diluted earnings per share were $2.28.

We saw broad based growth across all geographies and merchandising departments in the quarter. All 19 of our U.S. regions posted positive comps and internationally both Canada and Mexico reported positive comps in the fourth quarter.

As Ted will detail, both comp ticket and transactions grew in the core and we saw growth with both our Pro and DIY customers. We have strong holiday season with record setting sales on Black Friday and during Cyber Week. These results reflect solid execution by our stores, our merchants, our supply chain teams, as well as our vendor partners and demonstrate the overall health of the consumer.

I am proud of our results in fiscal 2019 is the team successfully navigated a number of external headwinds by maintaining a relentless focus on our customer. 2019 was also a pivotal year in our transformation to create the One Home Depot experience. We are now two years into our multiyear investment and are realizing benefits.

We have more conviction than ever that these strategic initiatives are creating a value proposition that is unique to the marketplace and will extend our leadership position for years to come. The majority of our U.S. stores have a new look and feel, and we address customer pinpoints around navigation and checkout.

Our enhanced signage and store refresh package, along with investments in the front-end of our stores have improved the customer experience and driven associate productivity. These store investments are driving higher customer satisfaction scores, which we believe is translating into market share gains.

As a compliment to our store investments, we’re investing to strengthen the competitive advantages that we have built through the blending of our physical and digital platforms into a more seamless interconnected experience.

For example, our chain wide rollout of digital appliance labels connecting ratings from the digital world to the physical world, enhancing the in-store shopping experience. Additionally, homedepot.com continues to be an engine for growth for our overall business, driving increased traffic online and additional footsteps to our stores, because of this, we continue to invest in search functionality, category presentations, product content and enhance fulfillment options to remove friction from the online shopping experience.

Excluding the extra week last year, online sales grew 20.8% in the quarter, and 21.4% for the year, and over 50% of the time, our customers choose to pick up their order in a store. This is the power of the interconnected retail strategy.

We’ve also expanded our digital capabilities by investing in B2B website experience tailored specifically for the needs of our Pro customers. We have now onboarded over 1 million Pro customers.

Additionally, during the quarter, we completed the integration of our third party best-in-class CRM system for all of our Pro sales and services teams. This enhances our visibility, enabling us to better serve our customers. I’m excited about the opportunities ahead as we continue to build capabilities to engage with a Pro, no matter when, where or how they want to interact.

Another key component of the best-in-class interconnected shopping experience centers on enhanced delivery and fulfillment options. In 2019, we continued our multiyear journey to create the fastest, most efficient delivery network in home improvement. We are now live with at least one of each type of facility that we’re building. So it is early days, we’re pleased with the initial results.

For example, we have opened a dozen Market Delivery Operations or MDOs that have enabled us to transition 20% of our clients’ deliveries from an outsourced model to one in which we control more of the customer experience. This is translated to meaningful improvements in our customer satisfaction scores for appliance deliveries. Our supply chain build-out will continue to ramp from here with the largest number of new facilities coming online in 2021 and 2022.

Turning to 2020, Richard will take you to the details, but we expect another year of growth, with both sales and top growth ranging from approximately 3.5% to 4%, and diluted earnings per share of approximately $10.45.

Today, our Board approved a 10% increase in our quarterly dividend to $1.50 per share, which equates to an annual dividend of $6 per share. We remain committed to maintaining a disciplined approach to capital allocation to create value for our shareholders.

I’m incredibly proud of the progress our teams made as we transform ourselves into the One Home Depot the future. While we define our sales growth in percentage terms, we capture share in dollar terms and to the second year of One Home Depot investment program, we have grown sales by over $9 billion, the level of growth unmatched in our market.

As we look forward to 2020, I am more excited than ever about the opportunities ahead. We’re investing to unlock the power of a truly interconnected customer experience by enhancing our already strong foundation to further extend our leadership position into the marketplace.

As with any transformation, the work we’re doing is complex and I’m proud of the way our associates continue to execute at higher levels and focus on what’s most important in our business, our customers.

I want to close by thanking our associates for the hard work and dedication in the fourth quarter and throughout the year. For the second half of the year, 100% of our stores will receive success sharing, our bonus program for our associates. We look forward to continuing our momentum in 2020.

And with that, let me turn the call over to Ted.

Ted Decker

Thanks, Craig. Good morning, everyone. We had a strong finish to the year with fourth quarter sales exceeding our expectations. We saw growth across historical Pro and DIY customers. All of our merchandising departments posted positive comps, but by our clients department, which posted double-digit comps in the quarter, constant decor and storage and tools were also above the company average. All other merchandising departments were positive but below the company top of 5.2%.

In the fourth quarter, comp average ticket increased 4.4% and comps transactions increased 0.8%. The strength in our comp was partially driven by a shift in our event timing, which Richard will talk through in a moment.

In addition, we had an excellent response to our Black Friday and Holiday events and our customers continue to trade up to new and innovative items. After experiencing significant deflation in lumber and copper during the first three quarters of 2019, commodity prices had a more neutral impact in the fourth quarter.

During the fourth quarter, big ticket concurrence actions those over $1,000, which represent approximately 20% of US sales were up double digits. The strength in our big ticket sales was driven in part by the shift in our event timing, as well as strong performance in number of other big ticket categories. During the fourth quarter big ticket categories like appliances, vinyl plank flooring, and our installation services business all posted costs above the company average.

Consumer demand is strong and this was evident during our annual Black Friday gift centre and decorative holiday events. The partnership and collaboration between our merchants and supplier partners help bring a fantastic lineup of great deals in special box categories like smartphone power tools, hand tools and decorative holiday.

Our unique assortment, together with excellent customer service and execution led to incredible results. Black Friday was a record sales day for our company and our gift centre event grew double digits versus last year.

We also saw our customers tackle a variety of projects around the house. During the fourth quarter we saw comps above the company average in several kitchen and bath categories, special or window coverings, cleaning and exterior paint. We also saw significant growth in our online only home decor categories, which we call HD Home as we build awareness from these high quality style forward assortments.

Sales for our Pro customers were healthy, driven by strength and categories like pneumatics, concrete, hand tools, and COGS all of which grew faster than the company average.

Looking back at 2019, our team continued their unwavering commitment to serve our customers with great everyday values and innovative product and we did this while investing in a customer back store interconnected experience to ensure that we continue to be the product authority and home improvement for years to come.

At our Investors Conference back in December, we talked about investments we were making across our business. We also shared our new ad campaign and tagline, How Doers Get More Done that we launched to highlight our investments into these new experiences and capabilities.

We believe that it’s important to signal to our customers that the Home Depot is evolving as their needs change. But it’s still early in our campaign, we see customers responding to our enhanced capabilities, giving us credit for saving them time and helping them complete their projects.

In response to our campaign, we saw one of our largest single days of downloads of our award winning mobile app and double-digit growth in usage of mobile tools like product locator and image search.

As we look forward to 2020, we will continue our investments to better meet our customers’ needs and drive a great shopping experience. One of the investments you’ll see in the first half of the year is a reset to our outdoor power equipment base.

We know the marketplace for outdoor power tools is transitioned to cordless technology and we’ve learned in our tools department that once a customer adopts a battery platform, they see tremendous value in sticking with that platform.

Similar to what we’ve done in our tools department, we’re in the process of resetting our outdoor powerful equipment phase to showcase our assortment by brand highlighting EGO, Toro, Milwaukee, Ryobi, Dewalt and Makita, many of which can only be found at the Home Depot.

To this new presentation, customers can clearly see and easily shop the value proposition that these cordless platforms bring including being more environmentally friendly, safer and easier to use, all with the power and runtime to get the job done. These powerful brands now have the lion’s share of batteries in the marketplace with hundreds of millions of batteries and customers homes and job sites today.

We currently offer over 1000 cordless power tools, and that number will continue to grow as our supplier partners are introducing innovative product all the time. Our comprehensive and unique assortment of outdoor power equipment resulted in double-digit comps in fiscal 2019.

The spring right around the corner, we are gearing up for another busy season. Our stores are stocked with new and innovative products and we just recently announced we are hiring 80,000 new associates to help us serve our customers during our spring selling season.

With that, I’d like to turn the call over to Richard

Richard McPhail

Thank you, Ted, and good morning, everyone. Before we begin, let me take a quick moment to remind everyone that fiscal 2019 consisted of 52 weeks, while fiscal ‘18 consisted of 53 weeks. This extra week added approximately $1.7 billion in sales for the fourth quarter of fiscal 2018. When we report our comparable sales or comps, we report them on a 52-week to 52-week basis by comparing weeks one-week through 52-week of fiscal 2019, with weeks two through 53 weeks of fiscal 2018

In the fourth quarter of 2019, total sales were $25.8 billion, a 2.7% decrease from last year, reflecting the compared against the extra week in 2018. Our total company comp sales in the fourth quarter increased 5.2% and comps in the U.S. increased 5.3%. Because of last year’s 53rd week and the resulting calendar shift, our monthly comps are distorted due to the timing of our annual Black Friday and Cyber Monday events this year versus last year.

Our reported monthly comps for the total company were positive 1.2% in November, 9.9% in December and 5.7% in January. Our monthly comps in the U.S. were positive 1.1% in November, 10.4% in December and 5.8% in January.

Given the distortion in our monthly comps caused by the calendar shift, we believe that it is more appropriate to look at November and December on a combined basis. For the combined two months of November and December, our total company comp was 5% followed by 5.7% in January.

For the year, our sales total record $110.2 billion. If we exclude the sales from the 53rd week in fiscal 2018, we grew sales by approximately $3.7 billion in fiscal 2019, a level of growth unmatched in our market. For the year, total company comp sales increased 3.5% and U.S. comp sales increased 3.8%.

In the fourth quarter, our gross margin was 33.9%, a decrease of 20 basis points from last year. Similar to last quarter, the change in our gross margin was primarily driven by higher shrink and a mix of products sold compared to last year. For the year, our gross margin was 34.1% slightly higher than our guidance at the beginning of the year.

In the fourth quarter operating expense as a percent sales decreased by 64 basis points to 20.7%, slightly better than our plan. During the quarter, we saw approximately 77 basis points of leverage, as we lapped the fiscal 2018 impairment of certain trade names and the 53rd week last year. This leverage was partially offset by expenses related to our strategic investment plan of approximately $280 million, which increased approximately $25 million from last year and cost 12 basis points of the average.

Fiscal 2019 operating expense as a percent of sales was 19.7%, a decrease of 28 basis points from last year. Our fiscal 2019 expense performance was better than our initial expectations, driven by productivity initiatives in our core business. During the year, we spent approximately $1 billion of investment expenses related to our strategic initiatives in line with our plan.

Our operating margin for the fourth quarter was approximately 13.2% and for the year was approximately 14.4%.

Interest and other expenses for the fourth quarter grew by $27 million to $292 million due primarily the higher long-term debt levels than one year ago.

In the fourth quarter, our effective tax rate was 20.3% and from fiscal 2019 was 23.6%. The lower than expected effective tax rate in the fourth quarter and for fiscal 2019, was driven primarily by several discrete tax items.

Our diluted earnings per share for the fourth quarter were $2.28, an increase of 9.1% from last year. For fiscal 2019, diluted earnings per share were $10.25, an increase of 5.3% compared to fiscal 2018.

Moving on to some additional highlights, we ended the year with a store count of 2291, while retail selling square footage was approximately 238 million square feet. For the fiscal year, total sales per retail square foot were $455, the highest in our company’s history.

At the end of the quarter, merchandise inventories grew $606 million to $14.5 billion and inventory terms were 4.9 times, down slightly versus last year. The growth in our inventory versus last year reflects the investments we’re making to accelerate merchandising resets and higher in stock levels than we had one year ago.

Moving on to capital allocation. In fiscal 2019, we generated approximately $13.7 billion of cash from operations and use that cash, as well as the proceeds from $2.4 billion of net debt issuances to invest in our business, pay dividends to our shareholders and repurchase our shares. During the year, we invested approximately $2.7 billion back into the business through capital expenditures. Further, we paid $6 billion in dividends to our shareholders.

Finally, during the year, we repurchased approximately $7 billion or about 32.8 million of our outstanding shares, including roughly $3.25 billion or 14.5 million shares in the fourth quarter.

Completed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 45.4%, 60 basis points higher than the end of fiscal 2018.

Today’s press release includes our guidance for fiscal 2020 and I want to take a few moments to comment on the highlights. Remember that we got off of GAAP, so fiscal 2012 guidance will watch from our reported results for fiscal 2019.

At our Investor Conference in December of 2019, we shared with you some preliminary thoughts for 2020 and we’re reiterating that guidance today. The economy is strong and the U.S. consumer is healthy.

The foundation of our sales plan starts with GDP and our 2020 sales guidance as soon as U.S. GDP growth of slightly less than 2% in 2020. The GDP, we add the impact that we think we will see from the housing environment, including demand driven by home price appreciation, housing turnover, household formation and the age of the housing stock.

As we look at these metrics, we see an environment that is healthy and stable. Our 2020 self guidance also assumes that we will continue to gain share in the marketplace. For fiscal 2020, we expect both sales growth and total company costs sales growth of approximately 3.5% to 4%. Fiscal 2020 represents the peak year of our investment program, and as a result, we expect our fiscal 2020 operating expenses to grow at 1.2 times the rate of our expected sales growth.

For the year, we expect to grow operating profit dollars to $16 billion, giving us an operating margin of approximately 14%. For fiscal 2020, we assume our effective tax rate will be approximately 24%. We expect fiscal 2020 diluted earnings per share to grow approximately 2% to $10.45.

For the year, we project cash flow from operations of approximately $13.5 billion. We plan to invest $2.8 billion of this cash back into the business in the form of capital expenditures. We also plan to use this cash to pay $6.4 billion in dividends and repurchase at least $5 billion of outstanding shares.

Before I close, I would like to update you on how we’re thinking about one of our capital allocation principles. With regards to our dividends in lieu of using a 55% payout ratio, we will look to grow our dividends every year as we grow earnings as we have for the last 11 years. This morning, we announced that our Board increased our quarterly dividend by 10%, which equates to an annual dividend of $6 per share.

With that, I want to thank you for your participation in today’s call. And Christine, we are now ready for questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Thank you. Our first question comes from line of Michael Lasser with UBS. Please proceed with your question.

Michael Lasser

Good morning. Thanks a lot for taking my question. It’s on any…

Craig Menear

Good morning.

Michael Lasser

Good morning. It’s on any potential supply disruption coming out of Asia. What have you factored in? What’s the current status of your supply chain? Have you seen any issues with getting product from Asia at this point? And if this extends for a meaningful period of time, what -- how do you size the potential impact to your sales and earnings over the next few quarters?

Craig Menear

So, Michael, let me -- I’ll start off and then I’ll hand it over to Mark Holifield. First of all, the guidance that we’ve provided, obviously, does not include any guidance update for the situation. It’s a very fluid situation that we’re monitoring closely. And all of our goods for Q1 are essentially onshore or on their way. So we feel pretty good about that situation. And Mark, do you might want to provide an update on...

Mark Holifield

Yeah. Sure, Craig. Yeah. As you mentioned, it does change every day. Our Q1 merchandise is already here or on the way and Q2 the picture is still developing there. For our direct import, our sourcing offices in Asia are in touch with our top factories as they are returning to operations. For our domestic vendors, we’re working with them to understand and mitigate any potential impacts in their supply chains.

Our teams working with all of our suppliers, both domestic and import, and our logistics service providers on a PO-by-PO, container by container basis to understand what the impacts of our product flow are and they’re taking appropriate action. We are encouraged that we’re seeing factories come back to work. Provinces coming back to work in China, but it is a fluid situation and highly variable in terms of what’s the current state?

Michael Lasser

And just to clarify, based on what you know today, do you think that there will be an earnings hit over the next couple of quarters based on any supply disruptions if this -- even if things get back to normal in the very near future so or do you have time to adjust based on what you know at this point?

Craig Menear

Michael based on what we know today, we couldn’t say that there would be a hit. Again, the teams are working this day-to-day, as Mark said to the PO-to-PO, container-to-container. We’re also putting plans in place and mitigate any risk going forward.

Michael Lasser

That’s what going in there…

Craig Menear

70% of what we do is domestic.

Michael Lasser

Okay. Thanks. My follow question is you just wrapped up your second year in a row with about 1% growth comp growth in traffic after many years of higher traffic than that. Is 1% growth in traffic the new norm and how do you think the implementation of your strategic investment plan is going to impact traffic in the next few years?

Craig Menear

The objective of what we’re doing on the investments plan is to position ourselves to be able to continue to grow faster than the market. I think, some of the growth that we saw in years past was a result of an accelerated recovery from a very difficult spot. What we’ve always focused on is how do we balance ticket and transactions, and that’s really where our focus is and the market will determine what level is that.

Michael Lasser

Okay. Thank you very much, and good luck.

Craig Menear

Thank you.

Operator

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

Scot Ciccarelli

Good morning, guys. I actually had a follow-up on Michael’s question first, like, I guess, the question is, given the delta that we’ve seen in transactions and average ticket. What would you guys point to regarding kind of what’s driving that divergence, I mean, and you just referenced you had a recovery phase, but I would think that recovery phase actually would, help both sides of that ledger, not just one.

Richard McPhail

Yes. So, I’d say we have some opportunity areas that we’ve invested in to continue to grow that is accelerated our ticket growth largely being we put significant investment in appliances, that has paid back in a in a very big way in terms of the accelerated growth we’ve seen in that business. Same thing would hold true for what Ted referenced as it relates to the lithium technology and the average ticket growth, we’ve seen power tools and now in outdoor power equipment.

So I think there is some innovation and investment factors that have helped drive ticket maybe even above and beyond as we took share in those categories. But we look pretty pleased with the consistency of our traffic growth over time. And like, I said, we’ll work to balance traffic and ticket we always want to make sure there’s a reasonable balance there.

Scot Ciccarelli

So when you think about -- I’m sorry, go ahead?

Ted Decker

I was just going to add, Scott, I’ll add to that Q4, very much event driven or gift center, decorative holiday, and as Craig said, appliances and those all performed incredibly well. So that contributes to the ticket and as we see consumers continue to trade up to the new innovative product that we’re offering.

And while we’re happy with transactions, they were a little bit depressed with the lack of cold weather. So if you think during a winter you get a lot of people stopping in for ice melt for that that smaller pickup even car washer fluid, et cetera, and with the more mild winter a lot of the biggest suppression there of transactions were those quick cold weather pick up items?

Scot Ciccarelli

Okay. That’s helpful. And I guess when you think about all the investments you guys have been making in the business and supply chain technology, should we continue expect kind of the pattern that we’ve seen here continue or is it have a more balanced impact as we go forward? Thanks

Craig Menear

Yeah. I think, again, we look for kind of balance in that will be perfect one way or another no, but we would look for balance.

Scot Ciccarelli

Okay. Thank you.

Operator

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

Simeon Gutman

Thanks. Good morning. Long-term question first, so thinking again about the payback from investments, it sounds like we’ll see some costs moderate next year, so that’ll be good to margin. But in terms of the topline lift and I realize you’re probably not going to quantify much. But can you tell us where the places will start to see better comps? Is it the Pro-wallet share, is it MRO categories, DIY? So what are the -- some of the KPIs that won’t be as apparent as comps that you’re seeing that that tells you that some of these investments are beginning to pay off?

Craig Menear

First of all, our investments are targeted for all the above that you just rolled out, probably, we think MRO you think consumer, our intent is to grow in all of those spaces. And but what we’re really trying to set ourselves up to do in the investment is to be able to position Home Depot to grow faster than the market growth on a consistent basis no matter what that environment is. That’s really what we’re trying to get done.

Simeon Gutman

And does that require waiting for the supply chain investment to finish rolling out or no that should stagger as all these other investments are taking place?

Craig Menear

I mean, the supply chain is a part of the overall component. As we’ve shared with you, we have investments that span across our business, whether that’s an investment in the store, whether that’s investments in the digital world, in our marketing elements and our product development, as well as the supply chain.

And we’ll see the -- as we put more and more of these capabilities in place as a supply chain continues to expand. As we open more facilities in ‘21 and ‘22, the bulk of those we’ll see that continue to grow as you put more capabilities against market.

Simeon Gutman

Okay. And then my follow up is in the fourth quarter, it looks like the business performed a little better than planned. Can you parse out underlying housing, signs and it may be improving versus some of the seasonal, it sounds like December was a big month, I don’t know if that’s more holiday, but at the same time, you didn’t have as much weather impact. So if you can just talk about underlying housing versus other drivers?

Richard McPhail

Sure. Simeon, this is Richard. So from a housing perspective, all housing indicators wind up really sort of where we expected them. And so we don’t think that that had any material impact on our business.

You mentioned December, there’s a little bit of a timing shift there in the calendar from November to December. But, overall, it was really the strong execution across the quarter and Ted maybe you want to go a little bit more into the strength of the quarter.

Ted Decker

Yeah. I think, as I said in my comments, we like the balance of ticket and transaction, we certainly like the balance of consumer in Pro and our Pro was strong in Q4, but we really saw the engaged consumer in -- whether more discretionary categories and terrific artificial Christmas tree business, our gift center record sales and growth and our gift center and appliances, as I said, double-digit comps in appliances, it’s not always just a refrigerator that’s broken being replaced, it’s increasingly discretionary purchases. So we just saw a very strong consumer.

Simeon Gutman

Great. Thank you.

Operator

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

Chuck Grom

Yeah. Thanks. Nice quarter. And normalizing for the event shifts sales are pretty consistent across the quarter. I’m just wondering how we think about the cadence of comps by quarter in 2020 and I’m wondering if you could offer some thoughts on how February started out?

Craig Menear

Well, thank you, Chuck. So we don’t provide quarterly guidance, but we would say that 2020 we will see are relatively evenly spread across the two half of the year with respect to the comp sales. And with respect to what we’ve seen so far in 2020, our guidance is based on the best information we have of the moment and so our results today are consistent with that guidance.

Chuck Grom

Okay. Great. And then just bigger picture is one of you guys could just amplify on the opportunity that you have with the Pro, as you onboard more of them onto the B2B website, particularly now that there’s going to be the CRM aspect included? Thanks.

Ted Decker

Yeah. I think when we think about the Pro customer, we’re actually building an ecosystem for our Pro customer that encompasses product and brands and delivery and credit services and our digital capabilities would B2B tool rental and a whole lot more. Obviously, all of that coming together allows us to be able to service our Pro customers in a more holistic way and it allows us to continue to grow with larger more complex customers.

And so, when we look at the Pro business and we think we’re in 15% to 17% range, and we’d love to see that the much more in line with consumer penetration of share that we have as we go forward, which is why we’re making these investments.

Chuck Grom

Thank you.

Operator

Thank you. Our next question comes from line of Christopher Horvers with J.P. Morgan. Please proceed with your question.

Christopher Horvers

Thanks. Good morning, everybody. So one to a couple follow up. So first on this seasonal business and the impact of the weather, overall, how would you assess the weather impact last year in December is really wet. I think you called out 85 basis points of headwind a year ago, you also had warm weather in January against Polar Vortex at the end there last year, but at the same time, you didn’t get the snow melt and the snow blower. So how would you assess your overall impact of weather?

Ted Decker

Chris, this is Ted. I’d say neutral. It’s just, as you said, extended season in some markets, the grounds not freezing, et cetera, that Pros could stay at work. But then on the other hand, you didn’t get all your cold weather categories, so our merchants in shore and snow and ice melt business aren’t as happy as some of our other merchants. But I would say on balance a little impact neutral?

Christopher Horvers

Got it. And then on the gross margin, so sequentially, the performance was better relative to the third quarter. You mentioned shrink and mix were still headwinds. And that, obviously, you talked about the Analyst Day they persisted into ‘20. But it did get a little bit better, what was the -- what shifted in the sense there and help offset that or did one of those factors mitigate, and does it change your view as you think about 2020?

Craig Menear

Shrink was consistent with what we have observed through the year and we are taking steps to address that in 2020 as we discussed. We had some great benefit as we’ve had all year from some of the supply chain investments we’re making and productivity supply chain, but shrink was consistent.

Christopher Horvers

And so the delta versus last quarter, anything to call out there?

Craig Menear

It’s really -- it’s a consistent trend, and as I said, we’re looking to address it started 2020.

Christopher Horvers

Got it. Thanks so much. Have a great spring

Craig Menear

Thanks.

Ted Decker

Thanks Chris.

Operator

Our next question comes from a line of Michael Baker with Nomura. Please proceed with your question.

Michael Baker

Hi. Thanks. A couple here. So one, the comp outlook for next year, 3.5 to 4. This year your comp at 3.5, but you were hurt by least 50 basis points from lumber. So essentially you got into a slow down next year and in fact the slowest comp in a number of years, when you adjust for inflation, yet housing seems to be getting better. So just curious disconnect there. Is it just sort of setting up for some potential upside?

Craig Menear

I mean like -- our methodology that we use, hasn’t changed and it’s not a perfect model. But Richard, do you want to just walk through this?

Richard McPhail

Yeah. Sure. We stay consistent with our methodology providing sales guidance and if you look at the elements of that methodology from GDP assumptions to what we’re thinking with respect to support from housing to the expectation that we will continue to take share. None of the assumptions behind those elements has changed significantly since December and so that’s why we’re reconfirming that outlet.

Craig Menear

And I -- one comment, I guess, people have always tried to think about our business as it relates to interest rates, just so we have never been able to correlate sales to interest rates. So that doesn’t come into our thinking as a result.

Michael Baker

But I guess a follow-up on that. You would think that your business correlates to housing, right, which I guess in turn correlates with interest rates. Is that a fair statement?

Craig Menear

It’s a fair statement. We -- and certainly, we’ve seen some of the indicators in very recent in the very recent time period, pick up a bit, but we’re not going to adjust guidance based on short-term fluctuations or observations in housing. We think housing is healthy and stable. It’s going to continue to provide positive support for business.

Michael Baker

Okay. That makes sense. If I can follow up, as I recall, the third quarter was hurt a little bit by the timing of Black Friday. So presumably that helped the fourth quarter, I get the shift in the month within the quarter, but third quarter versus fourth quarter, did that help fourth quarter at all, and if so by how much?

Craig Menear

Yeah. It was it was roughly a 35 basis points shift those ways, so it hurt Q3 about 35, it shifted that to Q4 by 35.

Michael Baker

Okay. Thank you. If I could slide in one more, you didn’t -- you said you don’t change your methodology and how you comp, but you are changing the methodology on the dividend, just wondering why you’re changing that is just a new CFO and a different way to think about it or do something, some other reason we should think about.

Richard McPhail

No. Look, we are maintaining our policy of wanting to increase our dividend every year as we grow earnings. We’re not going to tie to a specific payout ratio. But I think that this year’s increase of 10% is a great example of our intention to continue increase the dividend and also reflection of our confidence in business.

Michael Baker

Okay. Make sense. Appreciate the time.

Operator

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

Karen Short

Hi. Thanks. Actually just follow-up on that comment on the dividend, so is there a specific relationship we should think about as it relates to EPS growth versus dividend growth, because obviously, as you said, a 10% increases very impressive, given that in 2020, you’re kind of only looking for call it a 2% increase in earnings and presumably earnings growth will accelerate in ‘21?

Ted Decker

Look, our general philosophy around capital allocation hasn’t changed at all in terms of, first and foremost, we’re going to invest what we need to enter the business to continue to position this business to win for the long-term. Then based on access cash, we look at whatever opportunities might exist out there and we are committed to increasing our dividend on an annualized basis as we grow earnings. And then we’ll continue to look for ways to return dollars to the shareholders down any other opportunities through share repurchase. So those are the fundamental basics that you know we hold true in this business. We still want to -- we do control ourselves to a percentage basis.

Karen Short

Okay. Thanks. That’s helpful. And then on the 14% operating margin guidance, obviously, you came in a little a little bit higher this year at 14.4%, is anything to call it there in terms of the 40-basis-point decline versus the prior 30-basis-point?

Craig Menear

No. It’s really just a reflection of outperformance in Q4 and sort of rounding up to a 14.4% rather than, than our expectations around 2020, which has not changed. But with great execution across the business from sales to gross margins to operating expense, it was a team effort and we’re proud of the results we deliver.

Karen Short

Okay. And then just last one for me, is there any update you could provide on additional personalization and functionality on the B2B and maybe any color you could provide on behavior with the Pros and/or conversions with respect to the ones you’ve on-boarded?

Craig Menear

Look, we continue to drive engagement with the Pros that we’ve on-boarded to the B2B website. We like what we see as those Pros accelerate their engagement and -- but again, it -- we are also, as I mentioned before, we’re building a complete ecosystem around the Pro. The B2B website is one portion of that experience but encompasses all the things that I laid out before.

Karen Short

Okay. Great. Thanks

Operator

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

Brian Nagel

Hi. Good morning.

Craig Menear

Good morning.

Brian Nagel

Thank you for taking my question. Nice quarter.

Craig Menear

Thanks you.

Brian Nagel

So I wanted just take a step back a bit. At a meeting in December, we spent a lot of time talking about the investment initiatives. And then you would highlight the benefits of some of these were not coming as quickly as you initially thought that they were still coming. I guess, I want an update there, as we look at the business now, you had a very nice quarter, you seem -- excited about the initiatives. Have you seen more progress on that front then was articulated in December?

Craig Menear

Well, I think, as we shared in December that, we would continue to see the investments have a payback as we move forward and that is what we’re seeing. I think the quarter in particular, as Ted called, was a combination of the strength that we see in terms of the events that we put in place, the product offering that we brought to the market, the continued development of our initiatives. It’s all those things coming together that actually delivered on this quarter.

So, yeah, we’re pleased with the continued growth that we see in the initiatives. But at the same time, really proud of the team, the execution by our stores was outstanding. The supply chain team did a great job. Our suppliers gave us outstanding products and values. And the customer’s ability to start that shopping experience in the digital world and research product and/or purchase product there, all of that is leading to the kind of performance that we saw in the fourth quarter.

Brian Nagel

Got it. Then my follow up Craig and I guess so much of questions on shrink and other topic we spent a lot of times discussion in the December Analyst Meeting. How much of a swing factor could shrink be here in 2020 to the extent that you were able to improve the performance versus what we saw in 2019?

Craig Menear

I think as we shared in December, we’re in the process of implementing our initiatives to mitigate the impact from shrink. It will take time for us to actually realize the benefit as that flows through the P&L because we basically do the inventory in the stores once a while.

Ted Decker

And it’s a phased rollout.

Craig Menear

Right.

Ted Decker

We’ve piloted approaches. We feel very confident about those results, but we still learn as we go. We feel confident. And as Craig said, not only do you have the rollout, but you also have the actual recognition in the P&L, which is on a lag basis as we take inventories.

Brian Nagel

All right. Thank you and good luck to the spring.

Craig Menear

Thank you.

Ted Decker

Thank you.

Operator

Our next question comes from line of Elizabeth Suzuki with Bank of America Merrill Lynch. Please proceed with your question.

Elizabeth Suzuki

Great. Thank you. Regarding the margin guidance for 2020 can you talk about what assumptions you’re making for product margin and the mix impacts on gross margin?

Richard McPhail

Sure. For competitive reason, we don’t detail that…

Craig Menear

Yeah. We wouldn’t do that.

Richard McPhail

Yeah.

Elizabeth Suzuki

Okay. So on -- and but there’s no expectation that mix could be negative given that appliance sales have been so strong, for example, or is there anything built into your gross margin assumption in terms of mix?

Craig Menear

Well, there is, and as we had outlined in December, and if you think about the walk to the 14.0% guidance. You start with the fact that we’re going to generate operating expense leverage on a business as usual basis, sort of underlying everything. But then recall, this is the peak year of investment of our three year investment program. So that will put pressure on margin.

And then we see the impact from shrink, which is we said, we’re taking steps to address and also from mix, but the mixed pressure is a good pressure. This is the pressure that reflects the fact that we’re taking share in categories, like appliances like power tools, like outdoor power. And so, while we do think that there is mix pressure there, our objective is to grow incremental market share, incremental sales and incremental operating profit dollars and we do that through attacking our market opportunities in front of us.

Elizabeth Suzuki

Got it. Okay. And has there been products that have been excluded from terrorists retroactively where you’re now getting refunds and are those refunds a positive offset to your cost of goods sold?

Ted Decker

Yes. I would say, first off, huge thank you for our combined merchandising finance supply chain global sourcing team as they’ve worked through this tariff issue all year and we put a lot of effort on it and the teams did an exceptional job that follows into the exclusions because that’s a whole body of work that, excuse me, you need to follow what’s being submitted and requested to be excluded and literally get it down to the skew identifier and then file all the requisite paperwork to get the approvals, that the massive body of work that the team is currently undertaking. And one big category, huge growth category for us that has been excluded now is luxury vinyl plank in the flooring business, that’s probably the single biggest one and we’re actively working to get that refund back from tariffs previously paid.

Elizabeth Suzuki

Okay. So those -- and have those refunds impacted your fourth quarter at all or are they more going forward you’re likely to see some of that impact in the first half of the year?

Craig Menear

There was some of that.

Ted Decker

There was some benefit, but ins and outs of the quarter, we still feel great about the overall performance.

Elizabeth Suzuki

Okay. Thank you.

Operator

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

Zach Fadem

Hey. Good morning. Curious if you could speak specifically to the outlook for your e-commerce business in fiscal ‘20. And given all the initiatives around fulfillment and Pro, curious whether you expect that 20% growth handle to continue whether you’re still adding any categories and what you think that 2020 drivers could be?

Craig Menear

We’re excited about our e-commerce business as part of a whole interconnected retail strategy. We believe that the front door of our store is not on the customer’s pocket, it’s on the job site that most of our customer shopping experience actually starts in the digital world even if it finishes in the physical world.

As Ted has talked about, we have expanded our assortment into more categories online around the home. We think that is a continued opportunity as customers have shared with us that they believe that we can bring great value in these home categories and they trust us to bring that value. So we think that our digital business continues to be an engine for growth, both in the digital world and in the physical world.

Ted Decker

And it’s not a separate business. It is it is managed by our merchandising team, all one merchandising team, right? And so rather than think about a separate business, you have to think about as a capability.

Zach Fadem

Got it. And on the appliance category curious if you could talk a little more about the impact of taking home delivery in-house and considering your share gains in the category over the past several years. Could you comment on how much you think share wise is still up for grabs and where do you think it’s coming from?

Mark Holifield

Yeah. We are really pleased, excuse me, it’s Mark. We’re really pleased with the work we’ve done in our market delivery operations or MDOs. Those are staffed with orange apron, The Home Depot associates who are ensuring that the freight comes into those locations and is dispatched properly to the customer damage free. And they’re also working to ensure that there’s a great customer experience they’re working with the delivery teams.

So I really pleased with the progress there. As Craig mentioned in his comments, we’ve got a dozen of those up. We have another dozen or so leases signed, and we’re going to continue to roll those out through 2020 and as we do we continue to see an improvement to our on time performance, reschedule rate and or customer satisfaction.

Craig Menear

And I’d say an opportunity to keep growing. There’s still lots of participants regional, super regionals, even mom and pop furniture stores that have clients offering. So we think there’s still lots of share out there. I mean, clearly, Shears had been a donor over the years and very markedly diminished store base. But we still see just a huge market that we’ve had a disruptive attitude in this space for a long time and that’s continuing to pay dividends as we picture.

Zach Fadem

Got it. Appreciate the time.

Isabel Janci

Christine, we have time for one more question.

Operator

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

Seth Sigman

Great. Hey, guys. Thanks for squeezing me in. A couple follow ups here, first, on the guidance and specifically the cadence. Richard, I think he gave us a comp cadence similar throughout the year. How should we be thinking about gross margin and SG&A, and I guess, just the cadence of investments. Should we be thinking about more pressure on the operating margin in the first half relative to the second half.

Richard McPhail

First, we think about it in halves and we don’t provide specific half guidance. We’re looking in a relatively balanced year across the house.

Seth Sigman

Got it. Okay. And then just to follow up on the exit rate, January being a better month here, should we be thinking about any sort of pull-forward because of weather? Or do you think it’s some combination of your initiatives and just solid demand overall? And then just some related piece here around the macro, it sounds like you’re maintaining a relatively conservative view. I guess, my question is really are you seeing any sort of improvement or divergence in maybe markets that we’re slowing last year and are starting to get a little bit better, any change in performance there that would maybe lead you to believe that housing backdrop is just better for the business right now? Thanks.

Richard McPhail

I’d say, first of all, on regional variability, this past quarter was one of the narrowest we’ve seen in recent times and we don’t see any widespread variability. It’s really early to determine how the business plays out for the first half. We’ve always talked about this in terms of halves because anything can happen from a weather standpoint that could either accelerate or delay a spring and then you generally work to capture that in the first half. That’s really our approach. We’re not seeing anything that would have us any differently to that whatsoever.

Seth Sigman

Okay. Understood. Thanks a lot.

Operator

Thank you. We have reached the end of our allotted time for questions. Ms. Janci, I would now like to turn the floor back over to you for closing comments.

Isabel Janci

Great. Thank you, Christine. Thank you for joining us today. We look forward to speaking with you on our first quarter earnings call in May.

Operator

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