Q3 2021 Earnings Call

Company Participants

- Craig Menear, Chairman and Chief Executive Officer
- Edward Decker, President and Chief Operating Officer
- Isabel Janci, Vice President, Investor Relations and Treasurer
- Mark Holifield, Executive Vice President - Supply Chain & Product Development
- Richard McPhail, Executive Vice President and Chief Financial Officer

Other Participants

- Charles Grom, Analyst
- Christopher Horvers, Analyst
- Karen Short, Analyst
- Kate McShane, Analyst
- Michael Baker, Analyst
- Michael Lasser, Analyst
- Scot Ciccarelli, Analyst
- Simeon Gutman, Analyst
- Steven Forbes, Analyst
- Zack Fadem, Analyst

Presentation

Operator

Greetings and welcome to The Home Depot Third Quarter 2020 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 {BIO 20990226 <GO>}

Thank you, Christine, and good morning, everyone. Joining us on our call today are Craig Menear, Chairman and CEO; Ted Decker, President and Chief Operating Officer; and Richard McPhail, Executive Vice President and Chief Financial Officer.

Following our prepared remarks, the call will be open for questions. Questions will be limited to analysts and investors. And as a reminder, please limit yourself to one question with one follow-up. If we are unable to get to your question during the call, please call our Investor Relations department at 770-384-2387.

Before I turn the call over to 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 presentation 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 {BIO 15126612 <GO>}

Thank you, Isabel, and thanks for joining our call this morning. We hope that you and your loved ones are safe and healthy. As we announced yesterday, we entered into a definitive agreement to acquire HD Supply, a leading national distributor of maintenance, repair and operations products in the multifamily and hospitality end markets.

Before moving to the results of the quarter, I wanted to take a moment to discuss how HD Supply fits into our strategic framework. As you know, the MRO customers, an important Pro customer for The Home Depot. We are committed to better serving the MRO customers and growing in this space. The success we've had with our existing MRO business makes us confident in our ability to accelerate sales growth in a highly fragmented $55 billion MRO marketplace. While the transaction is subject to customary regulatory approvals, I look forward to welcoming the HD Supply associates to The Home Depot. Richard will take you through the financial details shortly.

Now, let's discuss our third quarter results. Sales for the third quarter grew $6.3 billion to $33.5 billion, up 23.2% from last year. Comp sales were up 24.1% from last year with U.S. comps of positive 24.6%. Diluted earnings per share were $3.18 in the third quarter. The third quarter was another exceptional quarter for The Home Depot, as we saw the continuation of outsized demand for home improvement projects. Our results were driven by broad-based strength across the store and geographies. All of our top 40 markets posted double-digit comps, while Canada posted comps above the company average, and Mexico posted its best performance since the onset of the pandemic with double-digit comps in local currency.

As Ted will detail both ticket and transactions were up double-digit in the quarter and we saw strong double-digit growth from both the Pro and DIY customers. As we mentioned last quarter, the step change in volume of business that we have witnessed over the last six months is not without its challenges. But our strategic investments, coupled with our near-term actions taken have allowed us to better serve our customers. Our third quarter performance is a reflection of this. And as we continued to learn and adapt to meet the unprecedented level of demand we are seeing in the market.

Actions we've taken across our supply chain in our stores and in partnership with our suppliers have helped us to improve in-stock levels, reduce lead times, better advantage in store replenishment, and improve fulfillment options and delivery times. All of this is ultimately translated over 300 basis points of sequential improvement in customer satisfaction scores for the third quarter. Our interconnected retail strategy and underlying technology infrastructure have continued to support record level web traffic on a consistent basis for over six months.

Sales leveraging our digital platforms increased approximately 80% versus the third quarter last year and approximately 60% of online orders were fulfilled through a store. We continue to invest in our digital assets introducing new capabilities and different ways to engage with The Home Depot. Over the past several months, we have refreshed the digital experience in key categories and are extremely pleased with the customer response. In decorative lighting for example, we enhance the category experienced, offer improved visual imaging and more lifestyle photos of our on-trend lighting assortment. As a result of these changes and increased marketing effort to better highlight our offering, we have seen significantly higher customer engagement with the category, online, which helped to drive sales growth above the company average in the quarter.

We also found new ways to leverage our online platform to better showcase our assortment for events. For our Halloween event, we increased our digital offering and enhanced our presentation which resonated with our customers, resulting in the strongest customer response we've had to these events. We are focused on continuing the momentum of our strategic investments to enhance the interconnected shopping experience and position ourselves for continued share capture over the long-term.

Key components of our One Home Depot strategy, such as opening various supply chain facilities, technology investments and enhancements to the digital experience remain on track. And we have now restarted many of the store investments that were paused at the onset of the pandemic. Our results through the first nine months of the year, clearly indicate that for many customers the home has never been more important. And we hear from them, that they will continue to invest in home improvement, through multitude of different projects and plan to embrace the upcoming holiday season.

As customers engage with The Home Depot, we see a continued blend of both the physical and digital worlds. As a result, the state competitive advantages and overarching benefits of an interconnected One Home Depot strategy have never been more relevant. I'm incredibly proud of our associates for the many ways that they have lived our values by serving our customers, communities and each other during these unquestionably challenging times. Our ability to grow the business by more than $15 billion through the first nine months of the year, while navigating the global pandemic and supporting our communities through multiple natural disasters, is a direct result of our associates extraordinary efforts.

Given the ongoing demands and complexity of the current environment, we continue to focus on taking care of our people, in part by extending weekly bonuses for hourly associates, in our stores and distribution centers for the duration of the third quarter.

Through the end of the third quarter, we have spent approximately $1.7 billion on temporary pay and benefits in response to COVID-19.

As Richard will discuss, we have now made the decision to transition from our temporary weekly bonus program to invest in permanent compensation enhancements for our frontline hourly associates. This will result in approximately $1 billion of incremental compensation expense on an annualized basis. Our orange-aproned associates are the heartbeat of The Home Depot and supporting them through this time of uncertainty and beyond continues to be a key priority. We know that we must remain agile and flexible to execute against the demands of the current environment.

And our third quarter performance highlights key progress that we have made as we continue to learn and adapt. I could not be more proud of the resilience and strength that our associates have continued to demonstrate. And I want to thank them and our supplier partners for their hard work and dedication to serving our customers and communities.

And finally, I want to take a quick moment to congratulate, Ted, Ann-Marie and Jeff, who are on the call with me today, on the recent promotions and expanded responsibilities. There are new roles -- among the number of leadership development moves, that we have made, as we continue to invest and grow the deep bunch of talent that we are fortunate to have here at The Home Depot.

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

Edward Decker {BIO 16614891 <GO>}

Thanks, Craig, and good morning, everyone. I want to thank all of our associates and supplier partners for their incredible effort to serve our customers in this unprecedented environment. The consistently strong demand we've seen over the last six months has been remarkable. For the last two quarters, we have seen comps north of 20% for 25 of the 26 weeks. The strong demand has pressured supply chain, partner with our supplier partners to make various improvements.

As we mentioned last quarter, the actions we took include adjusting our assortments and planograms, introducing alternative products and in some cases, reducing the number of SKUs in certain categories to focus on the highest demand products. In addition, we are further mechanizing a rapid deployment center network. They've now implemented mechanized fore loading and two-thirds of our facilities, meaningfully improving our productivity in those buildings.

As a result of all these actions, we have seen reduce product lead times and continued improvement in our in-stock positions. The in-stock level in our U.S. stores has improved for 12 straight weeks. While we are pleased with these results, we are not at pre-pandemic levels. We have also revisited customer fulfillment choices, some of which we paused earlier in the year. As a result, we are starting to reestablish premium delivery windows and express car and van delivery service, that covers over 70% of the U.S. population.

During the third quarter, each of our merchandising departments posted double digit comps led by our lumber in decor and storage departments. Our comp average ticket increased 10%, the comp transactions increased 13%. The growth in our comp average ticket was driven primarily by the continuation of project demand we saw in the second quarter. Customers trading up to new and innovative items, as well as inflation in certain commodity categories like lumber. Over the last four months, we've seen significant volatility in the pricing of lumber as the industry works to balance supply and demand. During the third quarter, the average price of framing lumber was approximately 130% higher than the same period last year.

As we exited the quarter, pricing for certain lumber categories had fallen from the peaks, we saw mid-quarter. But still sit well above the levels we saw this time last year. Despite the significant inflation, we saw strong double-digit unit comps in lumber in the third quarter. During the third quarter, inflation from core commodity categories positively impacted our average ticket growth by approximately 260 basis points. Additionally, the strength of our comp transaction growth was driven by consistently strong in-store and online transactions, continuing the same trends we saw in the second quarter.

During the third quarter, big-ticket comp transactions or those over $1,000 were up approximately 23%. We saw strong performance across a number of big-ticket categories like appliances, vinyl plank flooring and lumber. During the third quarter, we saw double-digit growth with both our Pro and DIY customers. And while DIY sales grew faster than Pro sales, our Pro business posted the strongest growth we've seen all year. As we look at our different Pro cohorts, growth with our smaller Pro customers has been consistent with strong double-digit growth every month of the year. Growth with our larger Pro customers is healthy and accelerated from the second quarter. However, some large Pro still face headwinds related to the current operating environment, including some customers being hesitant to invite Pros into their homes.

Turning to our DIY customers, we continue to see unprecedented levels of engagement from both new and existing customers across a variety of home improvement projects. And importantly as these customers complete a project, they're gaining the confidence to tackle their next project, and re-engage with the Home Depot. During the third quarter we saw customers take advantage of an extended selling season for garden seasonal categories, resulting in significant growth in categories like hardscapes, soils, riding mowers and outdoor power equipment. However, garden seasonal were not the only projects our customers were working on. If we exclude our garden departments from our third quarter results, our comp was still north of 20%. We saw customers working on a variety of projects across their home with categories like garage in organization, ceiling fans, vanities and power tools all posting comps, well above the company average.

The customer engagement we are seeing was also evident in our annual Halloween event. During the third quarter, we hosted our most successful Halloween event with both in-store and online offerings. Customers responded to our larger assortment of animatronics, inflatables and yard [ph] decor, as evidenced by our 12-foot giant skeleton, that sold out before October, helping drive a record level of sell-through for the event.

As we turn our attention to the fourth quarter, we are excited about the upcoming holiday season and believe we are in a great position for continued customer engagement. During the quarter, we will be hosting our annual holiday, Black Friday and gift center events. However, this year, they're going to look a little different. As we remain committed to prioritizing the health and safety of our customers and associates in promoting a safe shopping environment.

We've adjusted our Black Friday event this year to cover an extended period of time, and not just focus on one day. Additionally for both our Black Friday and our gift center events, we've reorganized how we place and stage our product to assist with social distancing. For example, we've reduced the amount of product displayed on our front race track, and we've created more space for gift center presentation. We've made deeper buys on fewer SKUs to bring great values to our customers. And we've also included some of our core SKUs in our event, which will help with replenishment as we continue to see strong comps.

For example, featured in our gift center, Black Friday events this year, our exclusive power tool products from our industry-leading assortment of Milwaukee, Makita, DEWALT, RIDGID, Ryobi, and more. This year, we are especially excited about the launch of Ryobi 18-volt, ONE+ HP Brushless tools. These tools have been designed from the ground up to serve our DIY and Pro customers with more features and performance than ever.

HP tools were up to 20% lighter and 30% more compact, while delivering pre-power and durability with brushless motors. The Ryobi ONE+ platform has more than 100 million batteries in our customers homes and job sites today. And this new HP lineup brings a strong pipeline of future innovation to the more than 175 Ryobi ONE+ tools in the marketplace today. Our Black Friday and gift center events kicked-off a little over a week ago, and we are thrilled with the early results.

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

Richard McPhail {BIO 19175260 <GO>}

Thank you, Ted, and good morning everyone. We appreciate everyone joining the call today and we hope you and your loved ones are safe and healthy. In the third quarter, total sales were $33.5 billion, a 23.2% increase from last year. Foreign exchange rates negatively impacted total sales growth by approximately $100 million. Our total company comps were positive 24.1% for the quarter with positive comps of 21.8% in August, 27.8% in September and 23% in October.

Comps in the U.S. were positive 24.6% for the quarter with positive comps of 22.6% in August, 28.5% in September and 23% in October. Our comps in August and September of this year were impacted by a shift in our Labor Day event. This year our Labor Day event fell in fiscal September and last year it fell in fiscal August. If we adjust for the shift, our monthly comps in the U.S. would be 24.7% in August and 26.4% in September. All 19 of our U.S. regions, as well as Canada and Mexico posted double digit positive comps in local currency.

In the third quarter, our gross margin was 34.2%, a decrease of approximately 30 basis points from last year. Gross margin was negatively impacted during the quarter by several factors, including product mix and pressure from shrink. Mix pressure from lumber alone negatively impacted gross margin by approximately 35 basis points in the third quarter. The decline in gross margin was partially offset by the benefit of reduced promotional events during the quarter. During the third quarter, operating expenses were approximately 19.7% of sales, representing a decrease of approximately 30 basis points compared to last year.

Let me take a moment to comment on a few of our expense items. First, during the quarter, we continued to support our associates with enhanced benefits in response to COVID-19, which totaled approximately $355 million, resulting in approximately 105 basis points of expense deleverage. As you heard earlier from Craig, through the end of the third quarter, we have spent approximately $1.7 billion on enhanced associate pay and benefits in response to COVDI-19. We've also made the decision to transition from our temporary weekly bonus program to permanent compensation enhancements for our frontline hourly associates. This will result in approximately $1 billion of incremental expense on an annual basis. We began making these adjustments in the third quarter and we'll continue to make the majority of them in the fourth quarter on a market-by-market basis.

Second, we incurred approximately $60 million of operational COVID related expenses, including personal protective equipment for our associates and customers and enhanced cleaning of our stores, resulting in approximately 20 basis points of operating expense deleverage. Third, we recorded expenses related to our strategic investment plan of approximately $325 million, an increase of approximately $48 million compared to last year. And finally, during the third quarter, we showed strong expense control in other areas of the business and drove approximately 155 basis points of expense leverage. Included in this 155 basis points of leverage, is approximately 70 basis points of pressure, driven by accrued bonus expense, primarily related to our current outperformance for our biannual store Success Sharing program and store and field based management bonuses for the second half. The Success Sharing in store and field based management bonuses are in addition to the $1.7 billion of enhanced pay and benefits in response to COVID-19.

Our operating margin for the third quarter was approximately 14.5%, flat with the same period last year. Interest and other expense for the third quarter grew by $49 million to $329 million due primarily to higher long-term debt levels compared to one year ago. In the third quarter, our effective tax rate was 24.1% compared to 24.5% in the third quarter of fiscal 2019. Our diluted earnings per share for the third quarter were $3.18, an increase of 25.7% compared to the third quarter of 2019. At the end of the quarter, merchandise inventories were $16.2 billion, an increase of $444 million versus last year. And inventory turns were 5.9 times, up from five times from the same period last year.

Moving on to capital allocation. Our long-term principles for how we think about deploying capital have not changed. After investing in the business, it is our intent to return excess cash to shareholders through a balanced approach of paying a healthy dividend and through share repurchases.

Let's take a moment to talk about our first priority. We are committed to reinvesting in the business to drive growth faster than the market. And the acquisition of HD Supply, strategically positions us to drive accelerated sales growth in a highly fragmented MRO space. Under the terms of the merger agreement, a subsidiary of the Home Depot will commence a cash tender offer to purchase all outstanding shares of HD Supply common stock for $56 per share for a total enterprise value, including net cash of approximately $8 billion.

The closing of the tender offer is subject to customary closing conditions, including regulatory approvals and the tender of a majority of the shares of HD Supply common stock been outstanding on a fully diluted basis, and is expected to be completed during the Home Depot's fiscal fourth quarter, which ends on January 31, 2021. We plan to finance the acquisition with cash on hand and new debt. We also expect the transaction to be accretive to EPS in fiscal 2021, with potential for significant shareholder value creation over the long term. During the quarter, we invested approximately $470 million back into our business in the form of capital expenditures and paid $1.6 billion in dividends to our shareholders. Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 41.6% down from 45.1% in the third quarter of fiscal 2019. This decrease primarily reflects our decision to temporarily enhance our liquidity position, including the suspension of our share repurchase program back in March.

Turning to the macro environment, the strong demand we've seen has continued. Comps have slightly accelerated in the first two weeks of November, reflecting an earlier start for our Black Friday and holiday events versus last year. We are encouraged by consumer sentiment and consumption trends, which show home improvement receiving more than its historical share of consumer spending. Housing metrics are significantly stronger than when we entered this crisis.

Turnover is rising. We see continued growth in household formation and home prices are appreciating as inventory on the market hovers near record lows. Our customers tell us their homes have never been more important, and they intend to continue their investment in the improvement of their homes. While the current demand environment is strong, it is important to remember that we are not through the COVID-19 pandemic. And we do not think it is prudent to extrapolate recent trends to predict future performance. Our main focus remains on meeting our customers needs, while prioritizing safety. And we believe that the investments we have made over the last several years have uniquely positioned us to capture market share, regardless of the environment.

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

Questions And Answers

Operator

Thank you. We will now be conducting a question-and-answer session. (Operator Instructions) Our first question comes from the line of Christopher Horvers with J.P.

Morgan. Please proceed with your question.

Q - Christopher Horvers {BIO 7499419 <GO>}

Thanks, good morning guys.

A - Craig Menear {BIO 15126612 <GO>}

Good morning.

Q - Christopher Horvers {BIO 7499419 <GO>}

So I know you mentioned about the slight acceleration quarter-to-date. But I wish, I was wondering what you've seen in areas where COVID cases have spiked, what do you think the business looks like as it gets colder and outdoor DIY gets tougher? You mentioned the low 20% ex-guarding comp, do you think that's a good proxy for the underlying trend? Would you expect the large Pro to continue to improve and provide a benefit?

A - Craig Menear {BIO 15126612 <GO>}

So, Chris, first comment would be, we've seen no correlation in the business as it relates to COVID cases. I mean, our performance overall was actually really tight geography-wise. And we saw broad strength across the store. So as Ted mentioned, we had an extended season because of the weather and garden, but we were extremely pleased with the performance outside of our outdoor categories. So we feel good about that. And we've seen the Pro continue to recover in the large Pro recover.

Q - Christopher Horvers {BIO 7499419 <GO>}

Got it. So, and then a couple of follow-up questions on the investment outlook. It sounds like you're making progress on the store investments again. We'll end up on track versus the original plan, and what do you think about the degree at which investment dollars in SG&A are down year-over-year in 2021?

And then now that you have HD Supply, I was curious how many of the 150 or so new buildings that you've planned to build under the current investment plan related to the MRO? And does the acquisition of HD Supply impact the outlook for the building those buildings and CapEx related to that? Thank you.

A - Richard McPhail {BIO 19175260 <GO>}

So with respect to investment outlook, as we've said in the past, we have deferred certain investments that principally relate to investments made inside the store. A large number of those investments remain deferred. We started the year with a CapEx plan of approximately $2.8 billion. We have deferred less than $0.5 billion. And so, while I won't give you an exact number, I would say, we will see deferral of -- call it $300 million to $400 million from our original plans in 2020. Some of that may push into 2021, and we'll update you as this time goes on. But I would say that overall, 2021 is going to be very similar to 2020 in terms of CapEx.

A - Edward Decker {BIO 16614891 <GO>}

And as it relates to the HD Supply asset base and total, obviously, we'll take a look at that and we'll evaluate the combined asset base once this gets approval and we'll move forward with what we think the best leverage point is to serve our customers and grow in the MRO space, which is a $55 billion fragmented market that we're pretty excited about.

A - Craig Menear {BIO 15126612 <GO>}

And if I could just take a minute, Chris, on what we've accomplished, while we did push a bit into 2021. We're just thrilled that we are finishing the investment in our new look and feel of the store, our sign packages will be done in all U.S. stores this year. I think that has probably the first time, the brand standard across all the United States stores has been the same, maybe since our first two stores opened in 1979. We've completed all our self checkout refreshes, we've added our storage to most of our stores for online pickup. We've implemented electronic sign labels in all our appliance departments, completely refreshed our paint -- color wall experience in our paint department. We've completed the tool (inaudible) by our brand standards in those leading brands, in our tool business. And we've also taken that to our outdoor power equipment and will be done early next year, resetting all our outdoor power equipment again by those battery platforms, that are leading brands in the industry. So we've completed a ton of work, despite some of the setbacks with COVID this year. The team just did a terrific job getting all that work done.

Q - Christopher Horvers {BIO 7499419 <GO>}

So then, Richard, I know you mentioned CapEx deferring in, but I think originally '21 was from an OpEx perspective. So our source of funds incremental investment dollars down year-over-year versus been for the past few years, do you still expect those investment dollars in OpEx to be down in '21?

A - Richard McPhail {BIO 19175260 <GO>}

They'll be flat down in '21, the specific expense dollars with respect to the investment program, that continue alongside the deferred spend in '20.

Q - Christopher Horvers {BIO 7499419 <GO>}

Got it. Have a great holiday season.

A - Craig Menear {BIO 15126612 <GO>}

Thank you.

Operator

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

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Good morning, guys. So you did talk about product mix as the primary factor for the gross margin decline. Was there much of an impact on gross margins from channel mix as e-commerce is outpaced store growth? Or is it really all in the product side or were there any other factors we should be mindful of? Thanks.

A - Craig Menear {BIO 15126612 <GO>}

Nothing in particular, Scott, by far the big driver was the lumber penetration, the lumber mix is strong as that business was.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

No. As we just thinking about this kind of going forward, Ted. So we think about if we wind up seeing a more normalized mix, kind of getting back to let's call flattish kind of gross margins, is that the right way to think about from a cadence perspective?

A - Edward Decker {BIO 16614891 <GO>}

I think at this point with the level of uncertainty in the environment and the dynamics in the business today, we wouldn't give any forward expectations with respect to margin. We're running a very healthy business, we're running on a portfolio basis. When you bring our channel mix, we run this as a portfolio and have for many, many years. And you've seen this stability in our gross margin reflects that. Remember that, over 60% of sales that are purchased on our digital assets were picked up in the store, and have an identical mix in essence to our store mix. So that's where we stand. We're very comfortable with the mix of business we see.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Okay. Very helpful. Thanks guys.

Operator

Our next 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 of taking my question. There is a lot of moving pieces with Home Depot's longer run earnings power between any changes in consumer behavior? The incremental cost that you're paying your associates, the acquisition of Home Depot, supply, channel mix. So relative to the 14% operating margin expectation you put out previously, recognizing that the sale expectation you're not providing longer run guidance. Do you think the business can now earn a higher, lower, or about the same margin knowing what you know today than what you had thought previously?

A - Richard McPhail {BIO 19175260 <GO>}

Well, I'd say, a lot is dynamic, but many things stay the same. I think, we have executed exceptionally well in terms of expense management throughout the year, and I think you can expect that from us in the future. I think one thing I will just make sure that we clarify, as how the shape of our investments to support our associates goes from 2020 into '21. So as we said, our expenses through the first three quarters of the year in support of our associates totaled approximately $1.7 billion. We are transitioning the nature of those investments into permanent wage investments during the fourth quarter. So if you think about the fourth quarter, we're not going to quite be down to that $1 billion annualized run rate as some of these programs lead into the beginning of the fourth quarter. We will be lower than the third quarter run rate. But added to $1.7 billion and say the 2020 will likely end at a total of $2 billion of investments in our associates. Of that $2 billion, only $1 billion will remain in our cost base in 2021. So I think that is -- that's the most important fact with respect to our cost base, that I'd like to make sure, we clarify.

A - Craig Menear {BIO 15126612 <GO>}

And Mike, the only other comment I'd have to that is everything that we've been doing through our investment program is to try to position The Home Depot to grow faster than the market on a consistent basis, no matter what the operating environment is, and to deliver incremental op margin dollars as a result. That's our focus. That's what we're trying to get done.

Q - Michael Lasser {BIO 7266130 <GO>}

Great. That's a good segue way to my second question, which is recognizing that it's very hard to prognosticate, how demand for overall home improvement is going to shape up next year? If you had to make an estimate, what percentage of your categories or you SKUs, do you think you'll be ordering inventory down next year?

A - Richard McPhail {BIO 19175260 <GO>}

Yeah, look we -- first of all, the inventory planning for The Home Depot is on a very short cycle. We plan really week-to-week, we release orders every single day and 70% of what we purchase is domestic goods and comes from short lead time type performance. So we'll manage that on a day-by-day, week-by-week basis based on what we see in demand. And really not looking, we're not looking to extrapolate anything at this point from current performance. Our whole focus is on being able to be flexible and agile and adjust accordingly.

Q - Michael Lasser {BIO 7266130 <GO>}

Okay. I guess the heart of the question was, do you think home improvement demand is going to grow next year?

A - Craig Menear {BIO 15126612 <GO>}

So look, the only thing I can tell you at this point is, when we talk to our customers and we do work on surveys, the customer tells us that the home has never been more important. Maintenance in the home is going up, as people spend way more time in their home. And they tell us, there is a significant percentage of folks that say, they're going to do a project within the next six months. And so everything that we see at this point in terms of customer feedback would suggest they're going to continue to invest in their homes.

A - Edward Decker {BIO 16614891 <GO>}

At the same time, there is a lot of uncertainty in the environment. There are macroeconomic fundamentals, that we're all going to be subject to. And so I think, if you think about it on a comparative basis as Craig said, home improvement is a great space to be in at the moment. And as customers, it was interesting to look at the housing dynamics. And you say when customers see their home price appreciate, they tend to invest more in their homes. Again, regarding our comments, because of the uncertainty in the macro environment. And so at this point, we really can't comment on '21, but we do think there is a lot of confidence with respect to home improvement in our customers mind.

Q - Michael Lasser {BIO 7266130 <GO>}

Understood. Thank you so much and have a really nice holiday.

A - Craig Menear {BIO 15126612 <GO>}

Thank you.

Operator

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

Q - Karen Short {BIO 20587902 <GO>}

Hi, thanks very much. Just a couple of questions, I guess, I'm wondering with respect to your inventory, following up on Michael's question. Do you actually think you maybe lost sales with the inventory that was a little too lean. And then, wondering how to think about inventory for the fourth quarter?

And then the second question, I had is just, you obviously have more and more information on your DIY customer, than you have for the last several quarters given the e-com penetration. I'm wondering if you can give a little more color on what the general demographic is looking like now? And what's the biggest shift or changes that you've seen from, I guess, age or income cohorts?

A - Edward Decker {BIO 16614891 <GO>}

On inventory, Karen, it would be hard to gauge some of the lost sales opportunity, that would have likely been more of a Q2 impact for us, because we did go in with a little more conservative approach when the pandemic hit. As you know, we limited customer hours, limited customer counts and we also pulled back a bit on inventory. Since that time though, between the merchandising team and the supply chain team and the sourcing teams and transportation team, they really have just done an incredible effort flowing product into the store.

And as I said in my prepared remarks, we improved in-stock levels every week of the quarter. Our inventory grew over $400 million from the prior year, that was our first year-over-year increase that we have seen this year. And in pure volume, if you look at our accounts payable, that gives you an indication of how much goods we have flown into the buildings, it's over $3 billion from our low point. So the in-stock still are not exactly where we'd like them to be. But incredible improvement in the work the merchants have done, even though the in-stocks still have some ways to go, by working on the right SKUs with our supplier partners, updating planograms in the like, where we believe we have the product in the type of items in the store, that our customers are looking for.

As it relates to online trends, you're absolutely right, our online business, we couldn't be happier with the performance of our digital assets and remember we are in interconnected business. So with everything I'm about to say, remember that over 60% odd of our goods are picked up in our store. Nonetheless, our interconnected business grew by 80%, the penetration was 13% to the business. The sales that translates to nearly $2 billion of sales growth in the quarter for our online business. Our visits are up dramatically. We're up in mobile, desktop, mobile web. Our conversion is up despite hyper growth in app and mobile web, they tend to have lower conversion rates than desktop.

Our app downloads are way up, our active app users are way up, our orders are up. Our -- my account, these are folks who are setting up an account with Home Depot, obviously we know them better when they set-up in account are way up. Millennials are highly engaged with The Home Depot, you asked about customer profile. Our Pros are highly engaged, our B2B website is seeing record volumes and engagement with our Pro customer. So I'll stop there, but it is a robust interconnected digital environment right now, The Home Depot.

Q - Karen Short {BIO 20587902 <GO>}

Great. Thanks very much.

Operator

Our next question comes from the line of Kate McShane with Goldman Sachs. Please proceed with your question.

Q - Kate McShane {BIO 7542899 <GO>}

Hi, good morning. Thanks for taking my question. I know there, you gave your comments on HD Supply. But I wondered if there was any more color you could give on the source and magnitude of any synergies and how much debt might be taken or raised for the deal?

A - Craig Menear {BIO 15126612 <GO>}

We're really excited about what the combination of these two MRO businesses will bring to our customer. We think we've got the opportunity to create significant shareholder value creation through that combination. We're not going to talk about the degree of accretion, but we're confident that we'll see earnings per share accretion in 2021.

A - Richard McPhail {BIO 19175260 <GO>}

Kate, what we're excited about it. These are rough numbers. If you think about a 130 million occupied households in United States, about 80 million of that is kind of owned household single family. There is 50 million that is rental, and of the 50 million, about 30 million, give or take is in kind of the multi-family operations type business. There is a huge opportunity for The Home Depot to continue to grow, not only on the MRO side, but as we build relationships with customers on the MRO side. We build relationships to be able to participate in capital refreshes of those facilities as well, which is something that we're pretty focused on. So we're super excited about the opportunity that comes with this MRO space.

Q - Kate McShane {BIO 7542899 <GO>}

Okay, thank you. And I wonder if I could ask an unrelated follow-up question, just regards to your seasonal business that you do in the fourth quarter, is there any way to dimensionalize or size how big of a business that is becoming for you in the fourth quarter?

A - Craig Menear {BIO 15126612 <GO>}

I'm trying to remember off the top of my head, we always -- we talked about seasonal breakout of outdoor categories. The fourth quarter is the lowest of the year, right, Ted?

A - Edward Decker {BIO 16614891 <GO>}

Yeah, so generally it's been shifting a little bit this year given the extended garden season and as engaged as customers have been. But usually think of Q4, of low 21%-ish penetration of what we would deem outdoor business. And that very much is the low point with Q2 traditionally being the high point, think of mid-30s, so that sort of the range of changes in the business.

Q - Kate McShane {BIO 7542899 <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>}

Thanks, good morning everyone. First, a question for Richard. You mentioned a few macro factors, I'm trying to extrapolate, it sounds like you're a little bit more bullish on those then maybe you're in prior calls. Can you give us any sense, I know you said directionally getting better. Can you give us a sense what these inputs could look like for 2021, just in terms of magnitude, whether it's home price appreciation, housing turnover, et cetera?

A - Richard McPhail {BIO 19175260 <GO>}

So in my earlier comments, I said we're really pleased with the current level of consumer sentiment and consumption in the economy. I'm not going to make a prediction on where those macroeconomic levers go in the future.

A - Craig Menear {BIO 15126612 <GO>}

I mean other thing Simeon, that I would say is, I think the last number I say is somewhere in, like the 2.7 months of supply in housing. That historical average on that is six months. So you'd have to believe that's going to continue to hold up home values. And I think home value improvements have been the surprise this year.

A - Richard McPhail {BIO 19175260 <GO>}

It's -- I think it's a positive housing environment. We're not extrapolating that into expectations for sales, principally because of the uncertainty in the macro-environment. So we are optimistic and current conditions are certainly favorable for home improvement, but there is uncertainty, we'll learn a lot in the fourth quarter.

Q - Simeon Gutman {BIO 7528320 <GO>}

Okay. Fair enough. And then my follow-up based on the results by customer type, right. The Pro customers coming back, can you talk about the backlog that you're seeing? Are you seeing the jobs that are coming back to normal indoor jobs? And I think it may have been asked earlier, but the transition from outdoor to indoor, how is that taking place?

A - Edward Decker {BIO 16614891 <GO>}

So, Simeon, you're right, that the Pro has been coming back. We see in a double-digit comps in Pro, we did last quarter as well, small Pro is leading the large Pro. We've seen that large Pro, really strength in the larger metro markets. In our services business, if you look at that as a benchmark to Pro's business, we have one of the larger backlogs to be installed, sales jobs that we've ever seen. And as you'd imagine lot of this special order goods, so getting the bespoke special order made and shipped to the particular job, and then getting the labor to install that job continues to be a bit of a pressure and more so in certain markets, leading to that large backlog. But what we're seeing in our services business translates to what the larger Pro's are also seeing that would be sizable backlog.

Q - Simeon Gutman {BIO 7528320 <GO>}

Thank you.

Operator

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

Q - Charles Grom {BIO 1450381 <GO>}

Hey, good morning, great quarter. Can you talk about where you are in the supply chain build-up, that you've outlined over the past few quarters? And maybe how much of a delay COVID caused and the degree to what you can make that up in '21?

A - Craig Menear {BIO 15126612 <GO>}

Sure. I'd just, largely, COVID hasn't had a big impact, and I'll let Mark comment on, where we are.

A - Mark Holifield {BIO 5952851 <GO>}

Yeah, good morning. Mark Holifield here. Yeah, we've continued to open facilities through the pandemic. I've been incredibly impressed that the team has been able to keep our program on track in terms of the One Supply Chain initiative. In Q3, we opened up about 11 MDOs. We now have three, but those are market delivery operations. We now have three flatbed delivery centers open. And we've got a very solid pipeline for '21, that we're working. And so we're very much on track with the one supply chain initiative.

Q - Charles Grom {BIO 1450381 <GO>}

Okay, that's great. And then maybe one for record, we spoke a lot over the past year, about the ongoing, margin headwind from shrink. And I realize maybe you've been limited in your ability to do some of the inventory, the physical inventories. But I think where are we in that lifecycle? It seems like it was an issue again here in the third quarter. Any line of sight of when you think the shrink to flip from a negative to a positive?

A - Craig Menear {BIO 15126612 <GO>}

Well, at the beginning of the year, we said that impacts from our initiatives weren't really going to be seen until the year 2021. It takes time to roll these out. We did anticipate at the beginning of the year that we would see pressure from a -- on a year-over-year basis. The results through the third quarter have been essentially consistent with our original expectations.

Operator

Our next question comes from the line of Michael Baker with D.A. Davidson. Please proceed with your question.

Q - Michael Baker {BIO 4323774 <GO>}

Hi, thanks. A couple. One, how are we being strong? Does that typically act as a leading indicator for Christmas or even Thanksgiving? In other words, people are buying the big (inaudible) for Halloween, does that translate into big Christmas or I don't know, if you do -- Thanksgiving business on that. But does that translate at all to what we should expect in the fourth quarter?

A - Craig Menear {BIO 15126612 <GO>}

I think what we saw in the Halloween business, probably is more correlated to what we've historically seen in store markets. When you have a hurricane hit, our thinking years ago was that, oh jeez, we needed to pullback on all that kind of product because that wouldn't be where the customer focus was and we needed to the space for rebuild type product. And what our customers told us was no actually, we're looking for some kind of normalcy. And we actually want to buy that product from you.

And I think that's exactly what we anticipated in -- and are seeing through the holiday programs is, Halloween was the strongest of that we've ever had. So we had anticipated in the beginning of the year because that's a long-cycle product that you purchase well in advance. We had anticipated that the customer would want to engage in holiday and purchased accordingly.

Q - Michael Baker {BIO 4323774 <GO>}

And so do you have that same expectation for Christmas? Did you purchase that similarly?

A - Craig Menear {BIO 15126612 <GO>}

Yeah, that's what I mean. We bought into the whole holiday to core for the entire season, Halloween all the way through Christmas because we anticipated the customers are going to want some kind of normalcy in their life. That holiday set has been set now for Christmas for several weeks in the store now. And as I've said, we're very pleased with the early engagement in sales in the program.

Q - Michael Baker {BIO 4323774 <GO>}

Yeah. Got it. Understood. If I could ask one more follow-up on the Home Depot supply, thinking back a few years to an Analyst Day, that you had, I think you implied that or said that you share in MRO was about 5% which would have implied about $2.5 billion. And then we add on 3 plus for Home Depot Supply. You're getting above $5 billion, about 10% share, is that the right way to think about it?

A - Craig Menear {BIO 15126612 <GO>}

We think it's a part of $55 billion market that we plan, with combination of our current MRO business and what will be added with HD Supply.

Q - Michael Baker {BIO 4323774 <GO>}

And what do you think your share is of that $55 billion?

A - Richard McPhail {BIO 19175260 <GO>}

We won't speak on HD supplies, financial information, the transaction hasn't completed yet, we'll refer you back to theirs [ph]. But as Craig said, call-out roughly $2 billion.

Q - Michael Baker {BIO 4323774 <GO>}

Understood. We can do that math. Thank you. Appreciate it.

Operator

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

Q - Zack Fadem

Good morning. So with your digital sales up 80% in the quarter, I think, I would imply that your in-store sales accelerated in Q3. And I'm curious if you would attribute this more so to the impact of using some of the early COVID restrictions on stores or do you think there are other factors like better in-stocks or incremental demand from Pro customers that you would call out?

A - Craig Menear {BIO 15126612 <GO>}

I think it's all of the above. I think, we learned how to better operate. We ended up turning control of constraints in stores over to our store managers who are closest to the situation on the ground, versus a company-wide approach. We did that roughly at the beginning of the quarter. We improved our in-stock position as Ted indicated. We saw overall improvement with our Pro customers and our smaller Pros have been steady. Our larger Pros improved, yet there is still opportunity for them. And we saw our services business improve overall. So I think there is a number of factors that led to this performance in the quarter. So we're pleased with the trends that we're seeing in the business right now.

Q - Zack Fadem

Got it. And then lastly on the decision to reacquire HD Supply. Could you talk about why you think the timing makes the most sense now, particularly with some of their end customers like hospitality and facilities impacted due to COVID. And on the strategic investments, curious how you would think about prioritizing that incremental investment dollar across the MRO business relative to your existing strategic plans?

A - Craig Menear {BIO 15126612 <GO>}

Look, I'd say a couple of things. First of all, over a period of time, the HD Supply business came down to essentially the MRO maintenance facility business, that it is today, that we just put the offer in on. And so it strategically aligns up with what we're trying to get accomplished in the MRO business, much more so, than they did a few years ago. So from a timing standpoint, that's the logic there. And look, we look forward to, as we close this deal, hopefully during our fiscal year-end here, then we'll determine the go forward approach, and how we allocate and prioritize, but we got to get this deal close first.

Q - Zack Fadem

Got it. Thanks, Craig. I appreciate the time.

A - Craig Menear {BIO 15126612 <GO>}

Sure.

A - Isabel Janci {BIO 20990226 <GO>}

And Christine, we have time for one more question.

Operator

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

Q - Steven Forbes {BIO 20413212 <GO>}

Good morning, and thanks for fitting me in. I was hoping to maybe expand on the compensation enhancements for the hourly associates. I don't know if it's possible, Richard or Craig, if you can discuss whether the investments are concentrated in absolute wage rates? Or if there is other sort of aspects of the compensation or benefits that are being changed as we think about the cost structure going forward?

A - Craig Menear {BIO 15126612 <GO>}

Look, Steven, we believe that our associates, our competitive advantage to the Home Depot and they are critical to the overall customer experience. And this investment is essentially in wage. And as we do everything as it relates to our associates, that's done on a market-by-market basis overall. But yes, you can think of it as largely, it's wage.

Q - Steven Forbes {BIO 20413212 <GO>}

And then as a follow-up to that, I mean should we expect any incremental pressure stemming from higher employment costs for the full-time associate or maybe I don't know if you've sort of discussed, right, the best way to think about 2021. Richard, you mentioned the 2 billion transitory whereas 1 billion permanent. But are there any other potential cost factors we should be considering in our models as it pertains to the full time (inaudible)?

A - Richard McPhail {BIO 19175260 <GO>}

It's all of our frontline associates essentially, whether full time, part time, doesn't matter.

Q - Steven Forbes {BIO 20413212 <GO>}

Thank you.

Operator

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

A - Isabel Janci {BIO 20990226 <GO>}

Thank you, Christine, and thank you everybody 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 at this time. Thank you for your participation and have a wonderful day.
