Q3 2022 Earnings Call

Company Participants

- Craig Menear, Chairman and Chief Executive Officer
- Isabel Janci, Vice President & Treasurer, Investor Relations
- Richard McPhail, Executive Vice president & Chief Financial Officer
- Ted Decker, President and Chief Operating Officer

Other Participants

- Brian Nagel, Analyst
- Christopher Horvers, Analyst
- Chuck Grom, Analyst
- Dennis McGill, Analyst
- Karen Short, Analyst
- Michael Lasser, Analyst
- Mike Baker, Analyst
- Simeon Gutman, Analyst
- Steven Forbes, Analyst
- Zach Fadem, Analyst

Presentation

Operator

Greetings and welcome to the Home Depot's Third Quarter 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. (Operator Instructions) As a reminder, this conference is being recorded. It is now my pleasure to introduce your host Isabel Janci. Please go ahead.

Isabel Janci {BIO 16473072 <GO>}

Thank you Christine and good morning everyone. Welcome to Home Depot's Third Quarter 2021 Earnings Call. 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 Investor Relations 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 good morning everyone. We appreciate you joining us on our call this morning. I'm pleased to report that we had another strong performance in the third quarter. Sales for the third quarter were $36.8 billion, up 9.8% from last year. Comp sales were up 6.1% from last year with U.S. comps of positive 5.5%. Diluted earnings per share were $3.92 in the third quarter, up from $3.18 in the third quarter last year.

Home improvement demand remains strong. Our customers remain engaged with projects around the home and we continue to focus on delivering the best experience in retail. As we mentioned last quarter, we continue to see customers taking on larger home improvement projects as evidenced by the continued strength with our pro customer which once again outpaced the DIY customer.

As it's been the case for the last 18 months, the team is doing an outstanding job of navigating a fluid and challenging operating environment. Ultimately, this is what has allowed us to respond to the strong home improvement demand that has persisted. We had positive comps every week despite unprecedented compares last year and grew sales by $3.3 billion in the third quarter, bringing total sales growth year-to-date to more than $15.5 billion through the third quarter.

From a geographic perspective, all of our 19 U.S. regions posted positive comps versus last year and both Canada and Mexico posted positive comps. These results were driven by our associates to have maintained a relentless focus on our customers while simultaneously managing industry-wide supply chain disruptions, inflation and a tight labor market.

While these factors present challenges for retail as a whole we will use our experience tools and our scale to manage through this environment with the intent to deliver a strong value proposition to our customers. We are thankful for the tenure and strength of our relationships with our supplier and transportation partners.

Our respective teams have worked tirelessly to build depth in key product categories and to flow products to our stores and distribution centers as quickly and efficiently as possible. I would like to thank them for their ongoing efforts as we continue to navigate one of the most challenging environments we have ever faced.

Beyond the current environment, we are focused on positioning ourselves for growth. We are investing in stores to drive further productivity which Ted will discuss. We are enhancing the interconnected shopping experience by investing to remove friction for our customers wherever possible and the build-out of our supply chain vision continues to progress and we remain on track with our plans. We are encouraged by the results that we're seeing from buildings that we have stood up as we optimize and assort these facilities to unlock their full potential.

We believe that the network we are building is unique to the market. It will not only enhance the customer experience from a delivery standpoint but also expand the opportunity to capture wallet share gains with both new and existing customers, drive efficiency end to end and leverage our scale to further extend our low-cost position in home improvement.

In the near term, we remain focused on being flexible and agile as we navigate this dynamic environment, but we also continue to leverage the momentum of our strategic investments to further enhance the interconnected shopping experience and support of our goals to drive growth faster than the market in any environment, further strengthen our position as a low-cost provider in home improvement with a relentless focus on productivity and efficiency and deliver exceptional shareholder value.

Our ability to invest for the future while also managing the most fluid environment in our company's history is a direct result of our associates and their extraordinary efforts. I want to thank all of our associates for the many ways they continue to live our values by serving our customers and communities. In conjunction with Veterans Day last week, the Home Depot Foundation announced that has now surpassed $400 million invested in support of U.S. military veterans since 2011. This brings us closer to achieve in our goal to invest a $0.5 billion in veteran causes by 2025. We honor and support our military veterans and families and we thank them for their service to our country.

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

Ted Decker {BIO 16614891 <GO>}

Thanks Craig and good morning everyone. We had a great third quarter. I want to start by thanking all our associates as well as the supplier and transportation pressures [ph] for their unwavering commitment to serving our customers and communities in what remains a very challenging operating environment. There is no question that pressures on global supply chains increased over the last 18 months.

That being said, we could not be more pleased with how our cross-functional teams responded. The teams took a number of decisive actions to secure more product for our customers, while continued to find new and different ways to flow that product. Beginning in the second quarter of last year, our merchant inventory and supply chain teams leveraged tools and analytics and worked with our vendor partners to adjust our assortments and in some cases introduce alternative products.

The teams also built depth in job lot quantities and high demand products. We improved our in-stock levels in the back half of last year and we've been able to sustain and in some cases improve our levels even as home improvement demand remains elevated. In addition to the challenging supply chain environment, we are also seeing rising cost pressures across several different product categories.

Our seasoned teams of merchandise and finance and data analytics associates are working with our supplier partners to manage through these pressures. We've effectively managed inflationary environments in the past and we feel good about our ability to continue managing through the current environment of being our customer's advocate for value.

Turning to our comp performance during the third quarter 12 of our 14 merchandising departments posted positive comps. Appliances, plumbing, electrical, building materials, tools, kitchen, bath, decor and storage and millwork and flooring had comps above the company average. Paint, outdoor gardening and hardware were positive but below the company average. Indoor garden was essentially flat and lumber posted a high single-digit negative comp compared with lumber comps more than 50% in the third quarter of 2020.

On a two-year basis, each of our departments posted healthy double-digit positive comps. Our comp average ticket increased 12.7% and comp transactions decreased 5.8%. Growth in our comp average ticket was driven in part by inflation across several product categories. Our commodity categories positively impacted our average ticket growth by approximately 70 basis points in the third quarter driven by inflation in copper and building materials, which was partially offset by deflation in lumber.

On a two-year basis, both comp average ticket and comp transactions were healthy and positive. Big-ticket comp transactions or those over $1,000 were up approximately 18% compared to the third quarter of last year. During the third quarter, Pro sales growth continued to outpace DIY growth. On a two-year comp basis growth in both our Pro and DIY customers was consistent and strong.

Similar to the second quarter, we saw many of our customers turn to Pros for help of larger projects. We see this in the strength of several Pro heavy categories like drywall, pneumatics, pipe and fittings and several millwork categories. We remain encouraged by what we are hearing from our Pros to say tell us their backlogs are healthy.

Sales leveraging our digital platforms grew approximately 8% for the third quarter, which brings our digital two-year growth to approximately 95%. Our customers continue to shop with us in an interconnected manner with approximately 55% of our online orders are fulfilled through our stores.

While we navigate these challenging environment, we continue to invest in our business to enhance the customer shopping experience while also driving productivity and efficiency. We believe we have a significant opportunity to further optimize space productivity in our stores by balancing the art and science of retail. This is a continuous process that we believe leads to better more productive assortments and space allocations, which ultimately drives value for our customers.

Let me take a moment to comment on some unique capabilities we've built that showcase what I mean. More than a year ago, we started to testing some of our higher volume stores. The idea was how can we further drive space productivity improve the shopping experience at the same time. Our cross-functional teams played a combination of space optimization models in conjunction with the expertise of our local field merchants, many of whom have more than 30 years of tenure with the Home Depot to create store-specific outcomes that adjust assortments and improved space utilization.

The results exceeded our expectations. Sales per square foot improved, on-shelf availability improved, voice of the customer scores improved, labor utilization improved, and during the process we were able to add net new base to the stores. As a result, we went from a small test to now targeting more than 400 stores this year with more in the pipeline for next year. I want to recognize all the teams helping drive the success.

As we turn our attention to the fourth quarter, we are excited about the upcoming holiday season. During the third quarter, we hosted our Halloween event and could not be happier with the results we saw record sales and sell through as customers responded to our exclusive product offerings and innovative approach to the category.

During the fourth quarter, we intend to continue this momentum with our annual holiday, Black Friday and gift center events. Like last year, we extended these events to cover a longer period, and not just focus on one day.

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

Richard McPhail {BIO 19175260 <GO>}

Thank you Ted and good morning everyone. In the third quarter, total sales were $36.8 billion, an increase of $3.3 billion or 9.8% from last year. Foreign exchange rates positively impacted total sales growth by approximately $190 million. During the third quarter, our total company comps were positive 6.1% with positive comps in all three months.

We saw total company comps of 3.1% in August, 4.5% in September and 9.9% in October. Comps in the U.S. were positive 5.5% for the quarter with comps of 2.2% in August, 4% in September and 9.6% in October. In the third quarter, our gross margin was 34.1%, a decrease of approximately 5 basis points from the same period last year.

While there are many factors that impact gross margin, during the third quarter our gross margin was negatively impacted by higher transportation costs and mix of products sold which was partially offset by higher retail prices. During the third quarter, operating expense as a percent of sales decreased approximately 130 basis points to 18.4%.

Our operating leverage during the third quarter reflects the lapping of significant COVID-related expenses that we incurred in the third quarter of 2020 to support our associates as well as payroll leverage. Our operating margin for the third quarter was 15.7% an increase of approximately 125 basis points from the third quarter of 2020.

Interest and other expense for the third quarter was essentially flat with the same period last year. In the third quarter, our effective tax rate was 24.5% up from 24.1% in the third quarter of fiscal 2020. Our diluted earnings per share for the third quarter were $3.92, an increase of 23.3% compared to the third quarter of 2020. At the end of the quarter, inventories were $20.6 billion up $4.4 billion from last year and inventory turns were 5.4 times compared with 5.9 times this time last year.

Turning to capital allocation. After investing in our business, it is our intent to return excess cash to shareholders in the form of dividends and share repurchases. As we've mentioned on previous calls, we plan to continue investing in our business with CapEx of approximately of sales on an annual basis. We also plan to maintain flexibility to move faster or slower depending on the environment. A good illustration of this is what you heard from Ted. We've built capabilities to drive productivity across some of our higher volume stores. We tested them, we saw strong results across key performance metrics and we moved quickly to expand the investment.

During the third quarter, we invested approximately $700 million back into our business in the form of capital expenditures, bringing year-to-date capital expenditures to approximately $1.7 billion. And, during the quarter, we paid approximately $1.7 billion in dividends to our shareholders and we returned approximately $3.5 billion to shareholders in the form of share repurchases.

Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 43.9% up from 41.6% in the third quarter of fiscal 2020.

As you've heard from Craig, we're very pleased with the strong performance we saw during the third quarter, particularly as we lap the unprecedented growth we saw this time last year. Customer engagement remains strong and demand for home improvement is healthy.

We've been pleased with our team's ability to navigate the challenging environment; however, we do not believe we can accurately predict how the external environment and cost pressures will evolve and how they will ultimately impact consumer spending. As we've mentioned on previous calls, our teams are managing our business on a relatively short cycle and we will continue to execute with flexibility and focus on what has driven our successful performance to-date.

Longer-term, we remain committed to what we believe is the winning formula for our customers, our associates and our shareholders. We intend to provide the best customer experience in home improvement we intend to extend our position as the low-cost provider. And, we intend to be the most efficient investor of capital in home improvement. If we do these things, we believe we will continue to grow faster than our market and we will deliver exceptional value to our shareholders.

Thank you for your participation in today's call, and Christine we will now open the call for questions.

Questions And Answers

Operator

Thank you. We will now be conducting a question-and-answer session. (Operator Instructions) Thank you. Our first question comes from the line of Simeon Gutman with Morgan Stanley. Please proceed with your question.

Q - Simeon Gutman {BIO 7528320 <GO>}

Hi everyone. Good morning. Nice quarter.

A - Craig Menear {BIO 15126612 <GO>}

Hi Craig.

Q - Simeon Gutman {BIO 7528320 <GO>}

My first question -- welcome. My first question is actually something I've asked last quarter and it's around demand reversion and whether the industry goes through some digestion phase or it continues to compound? And, just to add this quarter, it looks like there was very little reversion and demand seems to be holding even though we're probably getting out of stimulus so curious if you have any different thoughts about the demand progression?

A - Craig Menear {BIO 15126612 <GO>}

Simeon, I wish we actually do the exact answer to that, clearly we don't, and so one of the things that we've stayed focused on as a result then is how do we make sure that we're as flexible and agile as possible and deal with whatever comes our way. That has worked well for us so far. I think we've delivered strong performance. We're going to continue to be as nimble as we possibly can.

Candidly, we had expected that as the year progressed, you might see customers reverting back and spending in another areas and that may have affected us, but we really haven't seen that. Demand continues to remain strong. Customers continue to tell us that they have projects on their list, Pros tell us that their backlogs are significant. So, we're going to stay focused on filling that demand.

A - Richard McPhail {BIO 19175260 <GO>}

And,

Q - Simeon Gutman {BIO 7528320 <GO>}

Okay.

A - Richard McPhail {BIO 19175260 <GO>}

To add, to just add something, obviously, we saw acceleration in October. What's interesting to note is that we saw improvement in both ticket and transactions sequentially from September to October. So, we think that's a sign that the customer is engaged and demand is healthy.

Q - Simeon Gutman {BIO 7528320 <GO>}

Yeah, that's right. And then, maybe the follow-up is on the profit outlook or operating income and I know we're not -- we don't really cling to margin goals anymore it's more of operating profit dollar growth or EBIT growth. I was curious if this environment inhibits your ability to grow at the rates you want to grow in terms of operating profit or the consumer tends to take price in this segment and you can pass along price okay, and therefore over time, that shouldn't have an impact, meaning the operating profit dollar growth doesn't get touched?

A - Craig Menear {BIO 15126612 <GO>}

What I'd say is for the quarter and for the year to date, Simeon, we're very pleased with our performance. And, I think that our teams and Ted alluded to this, but the job we do in understanding and mitigating cost pressures and then as appropriate using a portfolio approach to cover those costs has been impressive. And, so we're happy with the P&L we delivered in Q3.

Q - Simeon Gutman {BIO 7528320 <GO>}

Okay, thanks. Good quarter.

A - Craig Menear {BIO 15126612 <GO>}

Thank you.

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.

A - Craig Menear {BIO 15126612 <GO>}

Good morning.

Q - Michael Lasser {BIO 7266130 <GO>}

Thanks a lot for taking my question. Home Depot's gross margins declined 10 out of the last 11 quarters. There was a moderation in the decline this quarter, is the period of gross margin degradation coming to an end and has this line item stabilized given the retail price increases that you're passing along and what was the impact from non-commodity related inflation to your comp in gross margin this quarter?

A - Craig Menear {BIO 15126612 <GO>}

Mike, I'd say one of the things we've shared with you all is we're very very focused on how do we drive incremental profit dollars and there is multiple ways to get there, and so that is our number one focus. It's not that we completely ignore rate, we obviously don't ignore rate in total, but you don't take rate to the bank. So, we are really laser-focused on the incremental operating profit dollar growth and we're very pleased. We said that in 2021 it would be a year of much more transparency on operating expense leverage, and that's what we've been focused on delivering.

On the last part of your question, we don't take the approach that we past costs on a unit basis and retails and costs move independently and so as Ted, if you think about just how, how that relationship worked?

A - Ted Decker {BIO 16614891 <GO>}

Yeah, Michael. I would say from a gross margin perspective, there was very little net impact from product cost pressures. So, as Richard said, we don't look at things necessarily on a unit-to-unit basis, but our merchants are well versed with running their portfolios and while we have certainly seen non-commodity cost impacts, those have largely been offset by increases overall in the retail portfolio.

Our cost pressures or margin pressures that we've seen in the past have been more related to our supply chain build-out, delivered sales, mix of product sales. We've talked about the appliance business in the past as an example, which is an incredibly productive high growth business with extremely high (inaudible) because of our inventory position but not necessarily the highest gross margin category.

If you look at our ticket growth, certainly there is an AUR, significant AUR double-digit growth, certainly a -- essentially half of that is from product costs that we have passed on, but it's important to note that our Pro and consumer customers remain incredibly engaged in this category and innovation and newness still sells in this marketplace and the equal amount of AUR was driven by mix in new product innovation. So, think of things like appliances, the technological and features and benefits that have been introduced into appliances, grills, in pellet grills smokers, our outdoor power equipment and power tools with our battery platforms. We just launched a new exclusive paint from BEHR and DYNASTY, this the best paint that Home Depot's ever introduced, its over $50 a gallon on shelf. It's performing incredibly well as customers trade up to the innovation, et cetera, et cetera.

So, yes, there's cost pressures that the merchants have offset but equally doing terrific job finding new and innovative product that our customers are engaging in.

Q - Michael Lasser {BIO 7266130 <GO>}

That's very helpful, thank you so much. My quick follow-up is the planning period associated with the one Home Depot is coming to a conclusion, should we expect a step up in operating expense investments as you move to 2022 and beyond as you have to continue to build out the capabilities that you've been deploying plus waging the inflation [ph] is going to continue to be quite high.

A - Craig Menear {BIO 15126612 <GO>}

I think -- so as we've said, we look at investment principally through the proxy of capital expenditures, and what we believe an appropriate level will be is around 2% of sales and that can vary, but you can think of that in your mind is where we expect to be. Beyond that, the associated operating expense is embedded in our cost structure now. And, so it's just a -- it's a normal part of our cost structure moving forward.There will always be fluctuations quarter-to-quarter.

We have productivity initiatives, we have invest in initiatives. There is a nice flywheel there of self-funding and again quarter-to-quarter you may see fluctuation but operating expense investments, that's just part of us now.

Q - Michael Lasser {BIO 7266130 <GO>}

Understood. Thank you.

Operator

Our next question comes from the line of Steven Forbes with Guggenheim. Please proceed with your question.

Q - Steven Forbes {BIO 20413212 <GO>}

Good morning. I wanted to start with Pro customer trends, so curious if you can discuss whether you're seeing an acceleration in new Pros maybe of all sizes migrate to Home Depot's offering given the industry-wide supply chain challenges? And then, also the pricing environment, which I believe really weighs on the value proposition of the independent. So, just any comment on growth in new Pros and if there is any difference among the size of the Pros themselves?

A - Craig Menear {BIO 15126612 <GO>}

Yeah, we're actually very pleased Steven with our overall continued growth with the Pro customer obviously our larger Pros were more challenged during the pandemic, and we've seen that recover what's really nice to see is on a two-year basis, really the conversion of both our Pro and our consumers growing at pretty comparable rates, and that's -- that is what we always strive to do.

We are attracting new Pros into the business and Ted I don't know if you want to comment on that?

A - Ted Decker {BIO 16614891 <GO>}

Yeah. We're happy Steven across our progression with our larger Pros and our smaller Pros. We've talked about their pipelines being healthy, record levels of remodel indexes in the marketplace and what we like about the Pros are they're responding to the capabilities that we've been building, so we've relaunched our Pro loyalty program. We're seeing record enrollment and engagement with the new loyalty program.

The Pros are responding to our capabilities in terms of delivered sales in our new supply chain. And, if you take a category like paint for example where we've had a Pro paint program for some time, we're in a terrific position with our two key paint suppliers PPG and BEHR, and we've seen a terrific uptake with our Pro paint volume as Pros continue to respond to the Pro paint itself, formulations, the pricing in the service level. So, our Pros are active across the business and engaging in all categories.

Q - Steven Forbes {BIO 20413212 <GO>}

That's helpful. Maybe, it leads to the follow-up on the B2B website. I don't know if you can comment on what you're seeing in regards to repeat behavior or retention rates, the point that I'm trying to get here, is it almost appears that this is a great environment for share capture and new customer growth for you and I don't know if you're sort of seeing elevated share or elevated repeat rate and retention rate within the B2B website that makes the stickiness of new customer growth apparent, any comment there would be helpful?

A - Ted Decker {BIO 16614891 <GO>}

Yeah, absolutely the ecosystem we're putting in place when you think of the B2B website, when you think of the new loyalty program or the revamp loyalty program also translating into the Pro app we're seeing record traffic on the app. The app traffic is growing, the Pro traffic on the app is growing, basket sizes and tickets and engagement is growing and our teams are doing an excellent job in stitching what we call households together.

So, our understanding and knowledge of all our customers, but particularly our Pro customers because they are engaging with us at a much higher frequency than the average consumer, we're able to stitch all that behavior together in a much more robust understanding of that customer and able to make direct contact with them to our digital marketing channels and our outreach with our field sales teams as well as our Pro associates in the stores.

So, that the entire Pro ecosystem with heavy emphasis on the digital capabilities is coming together extremely nicely in driving that stickiness and share of wallet.

Q - Steven Forbes {BIO 20413212 <GO>}

Thank you.

Operator

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

Q - Mike Baker {BIO 4323774 <GO>}

Thanks guys. And, so I know, you're probably not talking about fourth quarter guidance, but one thing I've noticed is that your fourth quarter very often, in fact, I think not in the last 12 years has been better than your third quarter. I think that's because of you guys continuing to lean more and more into holiday product. But, I'm wondering what you think of that, why is your fourth quarter typically such a strong quarter? And, maybe while we're talking about that, I know you said you're pleased with the beginning of the quarter oftentimes you give a little bit more color on the first couple of weeks. I'm wondering if you're willing to share any of that? Thanks.

A - Craig Menear {BIO 15126612 <GO>}

The fourth quarter and why has our fourth quarter been strong, I think we've brought tremendous value to the customer in the fourth quarter through the events that Ted talked about that we've done for multiple years now. Our merchants continue to focus on innovative products. As Ted mentioned in his prepared remarks around the Halloween event that was largely driven by just amazing innovative product that they brought into the marketplace.

So, I think in general, I think our team has done an outstanding job of delivering value to the customer in the fourth quarter, as we look forward into the fourth quarter we know that there is continued pressure that we're facing around cost which our teams will work to manage, we're still working some replenishment goods on our events out of the ports. and so we've got work to do there as well. And, of course in Q4, winter hits, so you never know how that's going to play out and over the past few years that hasn't been a big impact.

So, we've been very very pleased to your point on how our fourth quarter as has progressed over the years.

A - Richard McPhail {BIO 19175260 <GO>}

And, just to give you some color on how the fourth quarter has begun the comp sales for the first two weeks of the fourth quarter are running a little higher than what we reported for the entirety of the third quarter. But as Craig said, we're managing this on a short cycle basis in the current environment and are happy with how we've done it to date. But, we attack this thing everyday.

A - Ted Decker {BIO 16614891 <GO>}

And Mike, I would say just can't give enough credit for the merchants in the programs they put together over several years for the fourth quarter in leveraging our laid down space in the front of the store, in developing a gift center that truly just gets better and better each year. And if you walk our stores in, you see the product and the values that the merchants are bringing to the merchant -- bringing to the market place and you just look at the brand statement to see the Ryobi and the Milwaukee and the Makita and the

DeWalt and the Klein and the Diablo, I mean these are just the premier brands in the industry that the merchants bring unbelievable value in the most powerful gift center in our industry.

And just, just hats off to the merchant team and the great work they're doing.

Q - Mike Baker {BIO 4323774 <GO>}

Thanks, that's great color. One more completely unrelated question but Walmart, a lot of us are just on the Walmart call, they just said that they've actually seen it a little bit easier to hire people over the last couple of weeks or months since some of the employment stimulus has run out, are you seeing anything along those lines? Thanks.

A - Craig Menear {BIO 15126612 <GO>}

I mean, we've been fortunate in the sense that we've been able to hire a lots of people throughout 2021 and we use everything at our disposal as it relates to our brand to our culture to the total offering that we have, the growth opportunities for our associates. That's not to say that we don't have markets where there is pressure, there's always been markets that are more pressured than others, but we've been very pleased with our ability to hire folks.

Q - Mike Baker {BIO 4323774 <GO>}

Okay, thanks, I'll pass it on to someone else.

Operator

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

Q - Chuck Grom {BIO 3937478 <GO>}

Hey, thank you very much. Great quarter. I was wondering if we get an update on the One Supply Chain rollout? I guess where you are in the development of that, when we should expect to see better inventory availability and also some efficiencies on the distribution side?

A - Ted Decker {BIO 16614891 <GO>}

Sure, Chuck. We're very pleased, we're right on schedule with the rollout and as you know, this is a number of platforms. So, I'll try and give a quick rundown our transition to our new bulk distribution centers. We're replenishing our stores with lumber and building materials, it's going incredibly well. Our flatbed distribution centers that are often tied to those bulk distribution centers, we have seven or eight of those up and running now. Those are relieving the stores of the delivery volume out of the stores as well as being a capability to capture more share of the Pro wallet.

Our direct fulfillment centers, again we've opened up about seven of those, those are going to be an expansion of, we had three or four purpose-built pick pack and ship facilities, and as we look to cover 90% of the country, same or next-day delivery, we'll ultimately be 20 odd plus direct fulfillment centers will allow us to cover 90% of the country in parcel same and next day.

And then, finally our MDOs which is our flow through for big and bulky products particularly appliances, we're about halfway through the rollout there in we've taken over the delivery of about half of our appliance volume at this point. So, all are on target progressing nicely and performing at expectation.

A - Craig Menear {BIO 15126612 <GO>}

I think it's also important to note, Chuck that as Ted said we're progressing nicely, our teams are doing an incredible job. We also reserve the right to move appropriately. We've pivoted a few times during this development as we learned kind of the -- how to optimize the commercial offering and I don't think we're done learning yet. So, we're going to rollout at the right pace and the right pace means doing this right learning pivoting and optimizing the commercial promise of the network.

Q - Chuck Grom {BIO 3937478 <GO>}

That's very helpful, thank you very much. And then, just one near-term question. You talked about the Pro backlog being healthy, just wondering if you could put that into some context for us, has it actually increased to a degree given that maybe some people put off projects due to the rise in lumber, and now the lumber has come down, have we started of to see an increase? Just wanted some for some context on that.

A - Craig Menear {BIO 15126612 <GO>}

Yeah, I mean the conversations that we have with our Pro they have basically been multiple weeks and months and backlog and that continues. So, I have not seen any major shift.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay, thanks very much.

Operator

Our next 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 everybody. So, it looks like extra Labor Day shift August and September were pretty consistent, and then you had that really strong acceleration in October and on a two-year basis. So, can you talk about what you think drove that your acceleration, how much do you think maybe was price and do you have any concern that maybe we pull forward some of the holiday and seasonal spending given all the local news around you better get to the store and pickup your fake Christmas Tree? Thanks.

A - Craig Menear {BIO 15126612 <GO>}

Sure, Chris. I'll start and let some other comments come in. I'd say the first thing to recognize is that that acceleration was broad-based. We saw Pros, consumers, online; it all accelerated and as we moved through the quarter. So, we're very pleased to see that. I think in part as we're still high compared to norms, but as lumber came down to more reasonable levels compared to the last couple of years we certainly saw an acceleration there and that always carries across the store.

Lumber is a driver of projects throughout the business and that certainly carries on. So, we are really pleased with the broad base, it was geographic as well. We actually saw a narrowing of geographic variance during the quarter. So we're very, very pleased with how that played out.

A - Richard McPhail {BIO 19175260 <GO>}

And, as we said ticket and transaction both improved sequentially, so open question obviously will be how the consumer reacts in the future, but at least for October, both of those moves in positive direction.

Q - Christopher Horvers {BIO 7499419 <GO>}

Got it.

A - Ted Decker {BIO 16614891 <GO>}

There is a lot of the season to come. So, we're certainly pleased with the response to the gift centers I mentioned and our decorative holiday program the Christmas sets are following the strength of the Halloween, but we're earlier in the ramp-up to where the volumes come in starting next week, Thanksgiving week. So, a lot to go in the fourth quarter, but the ramp looks good.

Q - Christopher Horvers {BIO 7499419 <GO>}

Got it and then as a follow-up, you alluded a little bit price elasticity, are you seeing any of it, you have some pretty rapid inflation in areas like major appliances, I would assume anything coming in from Asia has a lot of freight-driven inflation, so in some of those bigger ticket areas or anywhere in the mix are you seeing any price elasticity which sort of is compressing volume perhaps down what do you think Whirlpool talked about but more than offset just by price?

A - Ted Decker {BIO 16614891 <GO>}

Yeah, I would say, certainly we watch it very carefully. We have not seen it broadly. I think lumber was the best example as Craig just alluded to and lumber prices were 3x and 4x the near-term levels. We clearly saw units drop-off, which then leads to project dropping off across the store as lumber prices came down and as we sit today for example framings up only about 5% on last year and panel is slightly below last year.

And, if you look back at the end of the second quarter, those prices were up significantly over prior years, framing had peaked out at roughly $1500 and we're down at about $575. So lumber clearly a commodity very representative of elasticities across the rest of the business. We haven't seen specific fall-offs in categories because of overly robust, if you will cost moves.

Watching it carefully but so far have not seen it.

A - Richard McPhail {BIO 19175260 <GO>}

And, I think it's important to note, look the cost environment is still dynamic, pressures are building, and so as Ted says, we haven't seen specific instances to date, but we are in a unique cost environment.

Q - Christopher Horvers {BIO 7499419 <GO>}

Got it. And, just sneak in one last one is, as you think about mix in the fourth quarter, does that generally have more of products that sourced as out of Asia, such that sort of that supply chain pressure that's hung up in inventory is a bigger pressure as we look at the fourth quarter?

A - Ted Decker {BIO 16614891 <GO>}

The mix, yes, Chris. So, you think of that the mix of gift center product less outdoor product, which is, you know you think of the garden department and pressure-treated lumber and more outdoor lumber oriented projects, those are suppressed somewhat in the fourth quarter. So, your mix of tools and the like that are largely sourced from overseas does impact Q4, and as Craig said we've received the most of the goods for the fourth quarter.

But, there is still product and we have 95 odd ships in total parked outside LA Long Beach and we track our containers on those ships and in also getting onto the ports and off the ports. So, we're not too terribly concerned. It is huge amounts of Q4, but there is Q4 products still working through the supply chain.

Q - Christopher Horvers {BIO 7499419 <GO>}

Got it. Have a great holiday season. Thanks.

A - Ted Decker {BIO 16614891 <GO>}

Thank you.

A - Craig Menear {BIO 15126612 <GO>}

Thank you.

Operator

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

Q - Karen Short {BIO 7215781 <GO>}

Hi. Thanks very much. So, one bigger picture question is just, I think I definitely heard from investor pushback that this elevated demand that we've seen is basically just going to be reduced back to the normal TAM once we get into 2022? And, I'm wondering what your perspective is on that because that doesn't seem likely, it just seems to me that the actual TAM is significantly higher on a much more permanently embedded basis? And then, I had another quick question.

A - Craig Menear {BIO 15126612 <GO>}

Karen, I think most people and if you looked at what economists were saying as the year started everybody believed during 2021 that we see a significant shift away from goods back to services as the economic environment opened up as we got our arms around the pandemic, clearly, we have not seen that. I'd say that from the standpoint that yes you've seen things like travel and restaurants open up, but the customers continue to spend in the home improvement space.

And, to date, we have not seen that dramatic shift back that everybody predicted. So, we're going to stay focused. We think that the underlying factors for the home improvement industry are strong and we're going to do everything we can to serve that demand going forward.

A - Richard McPhail {BIO 19175260 <GO>}

Yeah, I think long term when you look at all the factors we believe have driven home improvement demand we're in a very supportive environment. Short term harder to know where that demand moves, but long term there's a lot of support.

A - Craig Menear {BIO 15126612 <GO>}

And Karen, your point on total market where we're actually doing some refresh work on that right now. We'll probably talk more about that to you later on in the year, but we're resizing the market right now.

Q - Karen Short {BIO 7215781 <GO>}

Okay, great. And then, I just on this quarter and particular so sales growth versus EBIT growth that relationship is obviously very volatile, given all the moving parts, but EBIT growth relative to sales growth certainly widened in 3Q relative to 2Q. Wondering just how to think about that relationship in 4Q?

A - Richard McPhail {BIO 19175260 <GO>}

Well, so there really -- there is no typical quarter I think, we're pleased with the quarter, we're pleased with year-to-date. There's always going to be fluctuation quarter to quarter. If you think about Q3 flow through, there're really three significant dynamics. The first is that we're anniversarying significant COVID-related compensation and benefits from last year, but recall that we reinvested a good bit of that in the form of permanent wage increases at the end of last year.

The second dynamic is just the comparison between ticket and transaction comp, when ticket comp is higher than transaction because our payroll model is activity-based you're going to see more leverage than when you see in the converse when transaction outpaces ticket. So, we saw leverage benefit there.

And then, finally, to a much lesser degree as Craig said, we've hired a lot of people this year and feel great about how our stores are operating. We at the same time probably could have seen staffing a little higher if we had had our preference and we doing work on that.

A - Ted Decker {BIO 16614891 <GO>}

Yeah, we didn't; candidly, we do not expect October acceleration at the rate that it was, and so we probably had some opportunities from a staffing standpoint in October.

A - Richard McPhail {BIO 19175260 <GO>}

But, as far as flow through goes, again we do have cost pressure in the environment. We see product cost, we see transportation cost, we see wage pressure and all those things are real elements of today's economy. So, we'll continue to manage our best throughout, yes we're very pleased with the quarter.

Q - Karen Short {BIO 7215781 <GO>}

Great, thanks very much. Have a great holiday.

Operator

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

Q - Zach Fadem {BIO 18911015 <GO>}

Hey, good morning. As you think about all the favorable long-term indicators around housing be it turnover, home price appreciation, contractor backlogs, et cetera, are there any of these items more front and center in terms of driving demand today and as you think about the strength of your performance in the quarter, what would you attribute to the robust external environment versus what would you categorize its share gains?

A - Craig Menear {BIO 15126612 <GO>}

I mean, I'd say a couple of things here. First of all, when you look at the constrained availability of new housing that clearly is having a positive impact on the home values, and when customers home values are in a positive side of the ledger they feel good about investing in their homes, I think that is for sure an element that is helping the overall home improvement dynamic. That housing availability shortage probably is not going to get solved anytime soon at the rate that we're building homes even though it's an accelerated rate from where it's been that backlog is going to be there for quite some time.

Q - Zach Fadem {BIO 18911015 <GO>}

Got it and then as you look to 2022 and beyond, I realize you aren't providing any guidance, but as you think about all the drivers of your business today what do you think will be the primary areas of upside, be it from the Pro, DIY, innovation, your strategic initiatives, any thoughts there?

A - Craig Menear {BIO 15126612 <GO>}

Yeah, I mean, we think it's all of the above. We know we have an enormous opportunity with our Pro customers, particularly as we enhance our capabilities to grab a larger share of spend with the planned purchase with larger Pros and we believe that innovation, which is a huge element of both Pro and consumer but is certainly a driver for the consumer as well. And, people have spent a lot of time around their homes, they tell us that they've got project list that are things that they want to get done and so we feel good about the opportunity that exists with both the Pro and the Consumer looking forward.

Q - Zach Fadem {BIO 18911015 <GO>}

Got it. Thanks for the time, Craig.

A - Craig Menear {BIO 15126612 <GO>}

Sure.

Operator

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

Q - Brian Nagel {BIO 6638066 <GO>}

Hi, good morning.

A - Craig Menear {BIO 15126612 <GO>}

Good morning.

Q - Brian Nagel {BIO 6638066 <GO>}

Congratulations. Nice quarter. So a quick first question I have, that you had talked may be a quarter or two ago but just about how consumers are shopping your stores and as the pandemic or so to say is beginning to ease and what you saw is a shift from kind of weekend spending to weekday spending. I guess this from just help us understand better, I mean how this is -- how your traffic is progressing, obviously continued very strong, but are you seeing any further shift in just the way people shop in the stores?

A - Craig Menear {BIO 15126612 <GO>}

Yeah, actually throughout the third quarter, we saw a reacceleration of weekend traffic flow with no real deceleration during the week, and as I mentioned earlier that we saw consumer growth go up, Pro growth go up, online growth go up, geographically narrowed. So, we were very very pleased with the broad base improvement that we saw in all of those segments of our business and the increase on the weekends.

Q - Brian Nagel {BIO 6638066 <GO>}

Got it. So, but the second question I have though, look recognizing it's difficult to gauge market share in short periods of time, particularly against such a fluid backdrop, but just given the extraordinary lengths that Home Depot has gone to manage the supply chain pressures and done so well, do you think or do you see in your data that you actually capture increased share now from competitors out there may be some ancillary competitors that is not managing the supply chain as well as you are?

A - Craig Menear {BIO 15126612 <GO>}

I mean when we when we look at share, it's obviously a triangulation, there is no perfect data, but when you look at multiple different data points, whether that's from government data, from independent third parties that track, share and then of course as our conversations with our suppliers and what they're putting into the marketplace, we believe that we're continuing to gain share.

We think that our investments that we've made have helped us be in a position to continue to grow share, that was the objective behind why we made the investments. We want to be able to grow faster than the market in any environment whatsoever, and we feel like we're doing that right now. Exactly, who we're taking that share from is a little bit hard to know. We plan a really big market and it's highly fragmented. And, so, we think that we're capturing share but it -- based on category that can be very very different.

A - Ted Decker {BIO 16614891 <GO>}

Yeah, Brian, I would say if you look at the (inaudible) data that's that been a slug would indicate yet another quarter of taking share. But as we think about our scale and our position in the marketplace with the shortage of goods and particularly in certain categories, we've been very pleased with responses from long-term supplier partners and in some cases supplier partners saying we can't service the industry, so we'd rather focus on on the best partner and we called out in prior quarters with LP, the Louisiana-Pacific moving with us on OSB in exclusive manner, Carlon which is in electrical PVC boxes moving to us exclusive, Henry roof coatings just thrilled to mention this today just announced that they will be moving to us exclusive as well, Leviton which is the share leader in wiring devices another robust category exclusive to the Home Depot. And, I mentioned earlier, the position we're in with having joint supply from BEHR and Masco, as well as PPG in paint has given us great flow of liquid paint product as well.

So, I think our suppliers are leaning into the Home Depot and we couldn't be happier and more thankful for those relationships.

Q - Brian Nagel {BIO 6638066 <GO>}

Thanks Craig. I appreciate that color. Congrats again. Thank you.

A - Craig Menear {BIO 15126612 <GO>}

Thanks.

A - Isabel Janci {BIO 16473072 <GO>}

Christine, we have time for one more question.

Operator

Our final question will come from the line of Dennis McGill with Zelman. Please proceed with your question.

Q - Dennis McGill {BIO 6299739 <GO>}

Hi, thank you guys. Just a couple of quick ones on a bigger picture. On the acceleration from September to October, Richard, can you put any specifics behind how comp transactions trended? How much of an improvement you saw?

A - Richard McPhail {BIO 19175260 <GO>}

Don't want to break that out with the degree of improvement in transactions and ticket we're roughly equivalent?

Q - Dennis McGill {BIO 6299739 <GO>}

Okay, perfect. And then, any impact from the Northeast, Ida storms that you see in the data?

A - Richard McPhail {BIO 19175260 <GO>}

Maybe a $100 million, not necessarily that material, but obviously proud that we can be there for our community (Multiple Speakers).

Q - Dennis McGill {BIO 6299739 <GO>}

Okay, perfect. And then Ted, maybe bigger picture on the supply chain. Just curious, a lot of people, obviously speculating how long some of these challenges can persist. How do you think about maybe the bigger bottlenecks and how long those are maybe going to persist and how you guys would be able to maintain some of these advantages it seems you have in the marketplace with your superior supply chain infrastructure?

A - Ted Decker {BIO 16614891 <GO>}

Well, I think from the market, I mean it's hard to judge, but I would say this goes well into, if not through 2022 and we'll keep doing what we're doing with the innovation we've talked about and leveraging our scale as well as our new assets. I mean, when you think of our inventory growth, part of that is stocking these new facilities.

So, not only we improved our in-store stocking levels and been able to meet the accelerating demand through the quarter, but we're also starting, not starting we are stocking all those new facilities that I talked about. So, we're clearly getting disproportionate flow and that's where our merchants and supply chain teams will continue to push.

Q - Dennis McGill {BIO 6299739 <GO>}

Okay. Thank you. Good luck guys.

A - Ted Decker {BIO 16614891 <GO>}

Thank yoou.

A - Craig Menear {BIO 15126612 <GO>}

Thank you.

Operator

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

A - Isabel Janci {BIO 16473072 <GO>}

Thanks Christine and thank you all 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.
