Company Name: Home Depot
Company Ticker: HD US
Date: 2017-08-15
Event Description: Q2 2017 Earnings Call

Market Cap: 176,810.62
Current PX: 147.89
YTD Change($): +13.81
YTD Change(%): +10.300

Bloomberg Estimates - EPS
Current Quarter: 1.804
Current Year: 7.307
Bloomberg Estimates - Sales
Current Quarter: 24402.409
Current Year: 99723.731

Q2 2017 Earnings Call

Company Participants

- Diane Dayhoff
- Craig A. Menear
- Edward P. Decker
- Carol B. Tomé
- Mark Holifield
- Bill Lennie

Other Participants

- Simeon Ari Gutman
- Michael Louis Lasser
- Daniel Thomas Binder
- Christopher Horvers
- Brian Nagel
- Kate McShane
- Matthew J. Fassler
- Dennis Patrick McGill
- Alan Rifkin
- Scot Ciccarelli
- Keith Hughes
- Scott A. Mushkin
- Matthew McClintock
- Peter S. Benedict
- Seth M. Basham

MANAGEMENT DISCUSSION SECTION

Diane Dayhoff

Non-GAAP Financial Measures

Today's presentations will also include certain non-GAAP measures

Reconciliation of these measures is provided on our website

Craig A. Menear

Business Highlights

Sales and Diluted EPS

- We had strong quarter, achieving a milestone of the highest quarterly sales and net earnings results in the company history

- Sales for Q2 were $28.1B, up 6.2% from last year
- Comp sales were up 6.3% from last year, and our U.S. stores had a positive comp of 6.6%
- Diluted EPS were $2.25 in Q2, up 14.2% vs. last year

U.S

- We continue to see broad based growth across the store and all geographies
- In the U.S., all three of our divisions posted positive comps in Q2, as did all of our 19 regions and top 40 markets
- Internationally, both Mexico and Canada posted another quarter of positive comps in local currency

Store and Merchant Team

- Our solid performance was driven by the outstanding execution of our store and merchant teams delivering value and service for our customers across multiple event, both in-store and online
- As Ted will detail, both ticket and transactions grew in the quarter and all of our merchandising departments posted positive comps
- We saw a healthy balance of growth from both our Pro and DIY categories, with Pro sales once again outpacing DIY sales in the quarter

Acquisition of Compact Power Equipment

- We believe that the work that we are doing to enhance the service capabilities for the unique needs of our Pro customers continues to resonate
- We are focused on being a valued partner for our Pros by offering solutions both in store and at the jobsite that help them to more effectively manage their business
  - This includes enhancing our leadership position in tool rental
- During the quarter, we closed on the acquisition of Compact Power Equipment, a leading national provider of equipment rental and maintenance services
- Compact Power has provided larger jobsite equipment rentals at more than 1,000 Home Depot stores since 2009
- The acquisition is yet another investment to enhance our portfolio of service offerings for our Pro, and though we have worked closely with the Compact Power team for many years, we are delighted to officially welcome them to The Home Depot family

Investments

- Our investment in Interline and the MRO customer is another avenue to better serve the needs of our Pros. Use case one, the rollout of Interline's catalog of products to Home Depot stores is now implemented and we are pleased with the early results
- We also continue to rollout use case two, which enables Interline customers to shop Home Depot stores using a swipe card linked to their Interline account
- Though it is early days, we are seeing an incremental sales lift from accounts who have been given the swipe card

Dot-Com Business

- Our deeper level of engagement with the Interline customers has helped to drive sales growth that outpaced the company average in the quarter, and we remain very excited about the MRO opportunity going forward
- Another growth engine for our businesses is our focus on interconnected retail
- Our dot-com business represented 6.4% of sales and grew approximately 23% in the quarter
- Our digital team continues to invest in content, site improvement and better mobile experiences to take the friction out of the interconnected experience online, while our operations team remains focused on improving the interconnected experience in-store
- The result of these combined efforts is continued improvement in sales and customer satisfaction scores across both platforms
  - This is the power of interconnected retail

Productivity

- As you know, we look at productivity as a virtuous cycle here at The Home Depot, and our efforts to connect our business end to end continue to pay dividends that enable us to reinvest in the customer experience
- We are pleased with the productivity in the business during the quarter as the end to end initiatives to improve freight handling in the store continue to drive labor efficiency and optimize product flow from truck to shelf

Supply Chain Sync

- Beyond the four walls of our stores, we continue to drive productivity throughout our value chain with initiatives like Supply Chain Sync
- Sync is live in all of our RDCs, but as you know, this is a multiyear, multiphase endeavor as we work to onboard each of our suppliers' flowing product through our RDCs
- We continue to see great productivity from our supply chain as our investment over the past several years is having a positive impact on logistics costs, inventory productivity and service to our stores and customers

Macro Environment

- Turning to the macro environment, we continue to see positive signs in the housing data which we believe serve as a tailwind for our business
- As Carol will detail, because of our outperformance in H1 vs. our plan, we are increasing our sales and EPS guidance for the year
  - We now expect FY2017 sales growth of approximately 5.3% and diluted EPS of $7.29

Accomplishments

- The success of our spring selling season is the direct result of our 400,000-plus associates and their passion for our customers that extend well beyond serving them in our aisles
- For example, this year we celebrated the 20th anniversary of Home Depot's in-store kids workshops

- Held in our stores on the first Saturday of every month, these workshops have become a source of empowerment, accomplishment and pride for millions of children and their families
- We like to think that we're fostering the next generation of do-it-yourselfers with some of the most enthusiastic participants over the years, even trading in their mini aprons for larger ones by becoming associates in our stores themselves

Summary

I want to close by thanking all of our associates for their hard work and continued dedication to our customers as they once again successfully navigated the increased demands associated with our busiest selling season

Based on H1 results, approximately 99% of our stores qualified for Success Sharing, our profit-sharing program for our hourly associates

- We are very proud of their efforts

Edward P. Decker

Q2 Highlights

Online Business

- We had a great second quarter driven by strength with both our Pro and do-it-yourself customers
- In addition, our online business continued its momentum as online sales grew approximately 23% vs. last year
  - We saw a broad-based growth across the store as all of our merchandising departments posted positive comps
- Lumber, electrical, tools and flooring had double-digit comps in the quarter
- Building materials, appliances, indoor garden and decor were above the company average
- Plumbing, millwork, kitchen and bath, outdoor garden, hardware, paint and lighting were positive but below the company average

Price Inflation

- In Q2, total comp transactions grew by 2.6% and comp average ticket increased 3.6%
- Commodity price inflation in lumber, building materials and copper positively impacted average ticket growth by approximately 68BPS
- During the quarter, we held a Memorial Day, Father's Day, and Red, White and Blue events
  - These events drove excitement in our stores for both customers and associates, and we were very pleased with the results

U.S Sales

- Looking at big ticket sales in Q2, transactions over $900 which represent approximately 22% of our U.S. sales, were up 12.4%

- A few drivers behind the increase in big ticket purchases were appliances, flooring and certain Pro-heavy categories
- Transactions for tickets under $50, which now make up approximately 16% of our U.S. sales, grew by 1.5% in the quarter, reflecting among other things the return of our outdoor garden business in certain parts of the country

Pro Sales

- In Q2, Pro sales outpaced the company average, driven by both our high-spend and low-spend Pros. We saw strong comps across several lumber and building material categories, as well as categories like pipe and fittings, power tools and wire
- Sales to our DIY customers also showed strength in the quarter with flooring, storage and organization, and patio, all outperforming the company average comp

Core Merchandising Strategy

- We strive to balance the art and science of retail as part of our core merchandising strategy
- For example, we are using data to help our merchandising execution team, or MET, execute more effectively
- MET services the base in our stores with primary responsibility for planogram integrity and shelf presentation

Store Volume

- Currently, each base service is based on overall store volume
- We're initiating unique service rotations based on category-specific sales and transactions
- MET associates will receive individualized and optimized work assignments through their FIRST phones
  - This allows for the most efficient use of tasking ours and focuses base service where customers shop most
- Looking ahead, we will continue to build capabilities and invest in people, process and technology in order to leverage our data to better serve our customers

PPG TIMELESS Paint

- Now, let me turn our attention to Q3
- We strive to be the product authority in home improvement by providing our customers with the best brands at the best value
- Our assortment includes many exclusive brands, and we are excited to be expanding our launch of PPG branded products, a brand that has been trusted by Pros for over 100 years
- This quarter, we are introducing PPG TIMELESS paint
  - This new product guarantees one coat coverage and is available in both interior and exterior paint
- PPG's world-class coating technology improves durability, saving our customers time and money

Retail Strategy

- Product innovation is also at the forefront of our retail strategy

- Flooring, both hard and soft, has been an excellent growth driver for our business this year and we continue to see great innovation within the category
- New to our assortment is an improved vinyl plank flooring from LifeProof
    - This innovative product features a highly-engineered, closed-cell foamed PVC core that delivers rigidity and strength, yet is lightweight and easy to handle and install
- It is also 100% waterproof and scratch resistant, and is available in over 40 patterns
- This new LifeProof vinyl flooring is exclusive to The Home Depot
    - We're excited about our upcoming Labor Day, Fall Cleanup and Halloween, Harvest events in Q3
- As always, we will be offering a variety of special buys and values throughout the store and online to help kickoff the fall season

Carol B. Tomé

Financial Highlights

Sales

- In Q2, sales were $28.1B, a 6.2% increase from last year
- Our total company comps or same-store sales were positive 6.3% for the quarter, with positive comps up 5.8% in May, 5.9% in June and 7.2% in July
- Comps for U.S. stores were positive 6.6% for the quarter, with positive comps of 6.6% in May, 6.2% in June and 7% in July. vs. last year, a stronger U.S. dollar negatively impacted total sales growth by approximately $64mm or 0.2%

Gross Margin

- In Q2, our gross margin was 33.7%, a decline of 6BPS from last year
- The y-over-y change in our gross margin is explained largely by the following factors
    - First, we had 9BPS of gross margin expansion in our supply chain, driven primarily by increased productivity
    - Second, we had approximately 8BPS of gross margin contraction due to a change in the mix of products sold
    - And finally, we had 7BPS of gross margin contraction due to higher strength than one year ago

Operating Expense

- In Q2, operating expense as a percent of sales decreased by 44BPS to 17.8%
- In the quarter, our expenses were $20mm over our plan, due primarily to a true-up of our bonus accrual
- Even so, our operating expenses as a percent of sales were better than our plan due to our strong sales performance

Investments

- One last comment on expenses
- As we told you last quarter, we expect our expense growth factor to vary by quarter giving y-over-y comparisons and the timing of investments
- Looking ahead, we expect our expense growth factor to be lower in the back half of the year than it was in H1

Operating Margin

- Our operating margin for Q2 was 15.9%, an increase of 38BPS from last year
- Interest and other expense for Q2 grew by $21mm to $249mm, chiefly due to the impact of adding $4B to our outstanding long-term debt over the past year

Tax Rate

- In Q2, our effective tax rate was 36.6% compared to 37% in Q2 FY2016, reflecting the benefit of a new stock compensation accounting standard that we adopted at the beginning of the year
- Our diluted EPS for Q2 were $2.25, an increase of 14.2% from last year

New Store Openings

- Moving on to some additional highlights, in the first six months of the year we opened four new stores, including three in the U.S. and one in Mexico
- We have not opened a new store in the United States since 2013
- Our New York stores still open void, and we are pleased with their initial sales performance
- Total sales per square foot for Q2 were $464, up 5.9% from last year

Balance Sheet items

Inventory

- Turning to the balance sheet
- At the end of the quarter, merchandise inventories were $12.9B, up $545mm from last year, and inventory turn were 5.3 times, up one-tenth from last year
- In Q2, we repurchased $2.6B, or approximately 17.3mm shares of outstanding stock, bringing our YTD share repurchases to approximately $3.9B.
  - Additionally, during the quarter, we took advantage of an attractive interest rate environment and raised $2B of incremental long-term debt

Debt

- We will use the proceeds of this debt issuance to repurchase outstanding shares, increasing our 2017 share repurchase target from what had been $5B to now $7B
- Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 32%, 300BPS higher than Q2 FY2016

- YTD, our sales and EPS have exceeded our expectations

Outlook

Sales and EPS Growth

- Turning to our outlook for the remainder of the year, we expect to see continued growth in the repair and remodel market as the U.S. has experienced solid wage growth, faster home price appreciation and the reemergence of first-time homebuyer
- As a result, we are lifting our FY2017 sales and EPS growth guidance to reflect our H1 performance and are confident in the back half of the year

Compact Power Team

- In addition, as Craig mentioned, we recently completed the acquisition of Compact Power Equipment and are excited to welcome the Compact Power team to The Home Depot family
- As we look to the back half of the year, Compact Power will not have a material impact to our sales or EPS forecast, but it will slightly affect our gross margins and expense structure
- We now expect FY2017 sales to increase by approximately 5.3% with positive comps of 5.5%
  - While this suggests our H2 comps will be slightly lower than our H1 comps, our sales guidance is based on our planned foreign exchange rates for the back half of the year
- Given the recent performance of the U.S. dollar, there could be some upside to our sales forecast

Gross Margin

- At the beginning of the year, we expected our FY2017 gross margin to decline by 15BPS from what we reported in FY2016
- Reflecting the impact of Compact Power, we now expect our FY2017 gross margin to decline by approximately 10BPS.

EPS

- For the year, also reflecting the impact of Compact Power, we now expect our expenses to grow at approximately 46% of the rate of our sales growth
- Finally, for the year, we expect our effective tax rate to be approximately 36.3%
- For EPS, remember that we guide off of GAAP
- For FY2017, we now expect diluted EPS to increase by approximately 13% to $7.29
- Our updated EPS guidance reflects the points I just mentioned, as well as $7B of share repurchases for the year

QUESTION AND ANSWER SECTION

<Q - Simeon Ari Gutman>: Quick question, I guess, on the recovery. The longer the recovery persists, it’s just natural, it seems like the market is getting some angst, that there is eventually going to be a shoe to drop. How do you get comfortable with the tenor of the recovery? Clearly the business is performing great, and if there are yellow flags, how do you know what you're you looking for?

<A - Craig A. Menear>: I mean, I'd say, Simeon, that we've had obviously a protracted recovery here, and it has been clearly driven from housing, which has been a steady but slow recovery in the market. We continually look at months of supply, there's 4.3 months of supply in the market of housing availability against the historical norm of six. That clearly is helping to drive improvement in home value appreciation.

But housing starts haven't returned to their norm yet, either. The only thing that is kind of running at historical averages is housing turnover. So we see this housing favorability continuing as we look forward. And I think the watch out for us is you wouldn't want to see affordability become an issue, but that, at this point, doesn't seem to be a concern for us at all.

<A - Carol B. Tomé>: Right. As we look at the affordable index, it stands at 153%. So long ways to go before that would be a watch out for us. And recovery is a difficult thing to put your arms around, but if you look at simply PFRI dollars, they've only recovered 70% of the loss. So if you put that into baseball terms, I guess that's about the sixth inning.

The other thing that's really interesting to us is the age of the housing stock. We've talked to you a lot about 66% of the housing stock being older than 30 years. Well did you know that 51% of the housing stock is older than 40? And as houses age, well they need more repair.

<A - Edward P. Decker>: It's more to spend.

<Q - Simeon Ari Gutman>: Okay. That's helpful. My follow up is on e-commerce, and I'm sure this will be topical. I just want ask one angle of it. So in using the power tool category as an analog for how to think of appliances, the pushback that we've been getting is that, look, Home Depot has done a great job on power tools, but they have a lot of exclusive brands and labels which is different than appliances. And ultimately, appliances will be harder to control given some of the large national brands. Can you share some thoughts on that comment?

<A - Craig A. Menear>: Look. What I would say is we have a lot of categories of goods in our stores, over 200-plus categories of goods, and we compete with lots of folks across all of those categories. And candidly, by category the strategy is different because the categories are different. And so our job is to create the strategies that allow us to be the customers' advocate for value across the categories and compete accordingly, and it varies by category what our approach is.

<Q - Michael Louis Lasser>: I have two questions on market share. First, it looks like your total sales increased slightly less than the category according to the Census Bureau, so where do you think you might have lost some share to during the quarter? And then I have a follow-up on that.

<A - Craig A. Menear>: Actually, based on the NAICS 441, it actually looks that we gained share in the quarter. We don't believe we lost share the quarter.

<A - Carol B. Tomé>: No. We're up 20BPS.

<A - Craig A. Menear>: Yeah, 20BPS y-over-y.

<Q - Michael Louis Lasser>: So do you think other...

<A - Edward P. Decker>: 20BPS to $28.12B.

<A - Craig A. Menear>: Right.

<Q - Michael Louis Lasser>: Okay. And then the second part of the question is on e-commerce. The e-commerce channel within home improvement overall, do you think that you're gaining share within that channel, within the category? And what rate of growth do you think the home improvement category is growing online?

<A - Craig A. Menear>: We actually have an interconnected retail approach, and our customers are blending the physical and the digital world together. And we look at share in totality as it relates to Home Depot's gain in the market against what the market is growing.

<A - Carol B. Tomé>: And we're pleased with the share gains. It's important to remember that over 43% of our online transactions are picked up inside of a store. This is one Home Depot, not an online or in-store business, but it's one Home Depot.

<Q - Daniel Thomas Binder>: As you just mentioned, different strategies for different categories online. Obviously appliances have been in the news recently. I know you do some of your appliance business online. I was wondering if you could just talk a little bit about the complexity of that transaction, how the customer is shopping it in the store, even if they're ordering it online? And where you think your competitive advantages are if you started to see that category become more available online at other competitors?

<A - Craig A. Menear>: Dan, look, if you look at the interconnected experience, candidly for appliances, there are lots of other categories. In many, many categories, the shopping experience starts in the digital world even though it might finish in the physical world, or in some cases actually finish in the digital world as well.

It is truly a blended experience today where the customer at the front door of our store is no longer at the front door of our physical store for many, many product categories. The customer starts digitally looking at product, doing research, and then in many cases, particularly in large ticket, they come in and they actually want to talk to one of our associates before they make a purchase. But we clearly – in big ticket categories, we sell both in the physical and the digital world.

<Q - Daniel Thomas Binder>: And then if I could just ask one other question related to delivery, can you give us an update on how many of the stores are able to deliver to the Pro within two hours now?

<A - Craig A. Menear>: Yeah. We've actually rolled out the delivery program at the end of FY2016. Mark Holifield is here. I'll let Mark.

<A - Mark Holifield>: Yes. Hey, Dan. Our Buy Online, Deliver From Store and our deliver from store capabilities were fully rolled out at the end of last year, and we offer the two and four-hour window options at all of them at this point.

<A - Carol B. Tomé>: And, Mark, it's true we've seen sequential growth in our delivery business every week in the quarter. So our customers are responding very well to this offer.

<A - Mark Holifield>: Very healthy growth.

<Q - Christopher Horvers>: Can you talk about – Carol, last quarter, you talked about Pro being up 2 times DIY. Did that trend continue? And can you talk about the growth that you're seeing in the Pro vs. DIY? What does that make you all think about what's going on in the market now and in terms of the duration of the growth going forward?

<A - Carol B. Tomé>: Sure. So, yes. Our Pros grew twice as fast than the DIY. It actually expanded that gap a bit in Q2. And, Chris, I can recall talking to you last August about our sales and our Pros going out on vacation. Well, based on what we're seeing in the stores today, our Pros are not on vacation. The stores are busy and our sales are quite good.

<Q - Christopher Horvers>: Nice. And then, I think one of the questions that was asked on our last visit I thought it was really interesting and wanted to put out there, you have companies like Wayfair spending a lot on advertising, and Amazon's reported to be more interested in the category. So, obviously, as you saw these companies get rewarded with sales growth and not necessarily profitability, clear in Amazon's last report. So, do you think that given this increased interest in greater advertising spend, do you need to flex some muscles here and maybe deleverage advertising a little bit to defend The Home Depot brand in the home-related categories?

<A - Craig A. Menear>: Chris, I'd say, one of the things I'm very proud of the team, they have worked really hard over the past several years to drive dramatic improvement in terms of the effectiveness of our marketing dollars to reach a customer in a space where they have a high level of interest. So, we have been on a path to balance our approach in terms of marketing, both in traditional media and in digital media, and the team has been able to drive incredibly effective returns on our marketing spend.

<A - Carol B. Tomé>: We spent more on digital in Q2 than we did TV and radio combined. So the team's doing an awesome job of getting more eyeballs, higher return on that spend.

<A - Edward P. Decker>: Yeah. Our overall advertising spend is up lower-single digits. But as we've essentially made a more significant pivot to digital marketing, it's over half our marketing right now, that's a medium that you can get good insight on the return on your spend. And as Craig said, the team's just done a great job continuing to increase the return on that spend, so leveraging that low-single digit to a much more productive return on overall ad spend.

<Q - Christopher Horvers>: All right. I'm sure you do a lot of key search terms and so forth there. Is that becoming more expensive to you as Wayfair and Amazon focus more on the category?

<A - Craig A. Menear>: I mean it varies by category by day, candidly.

<Q - Brian Nagel>: So my first question, I guess, just follow-up on some of the other e-commerce type questions, but maybe to what exactly Chris was saying just a minute ago. The other e-tailers or online omnichannels, if it meet – at least indicates some interest gain in this category But from your vantage point, are you seeing anything suggest that anyone's coming out with a much, much more price-aggressive effort, and one that you would have to match or you're choosing to match?

<A - Craig A. Menear>: I mean, Brian, we've invested, obviously, in tools and capabilities to inform our merchants in terms of the overall competitive position in the marketplace, both in the digital and the physical world. And this, quite candidly, has been something that the company has been focused on since its inception in terms of making sure that we're driving value. Core belief that I have is as merchants, we are the customers' advocate for value, period. And that's the job of The Home Depot and The Home Depot merchandising team every single day. So we must stay focused on a competitive offering. And quite candidly, value is defined by what the customer is willing to pay for.

<Q - Brian Nagel>: Got it. Okay. My follow-up question, I mean, shifting gears a bit, flooring. I think you called that out as another bright spot. Again, from a competitive standpoint, there's other companies now that are pushing into the flooring from a specialty perspective. Overall, what are you seeing as far as – I guess how would you characterize the consumer demand of the category? And then, are you seeing anything from stepped up competitions you've had to react to?

<A - Edward P. Decker>: No, as Craig said, it's a great point. We competed over 220 categories, flooring is a very big category. And there are actually a lot of competitors have been and will be. We see consumer demand very strong and the consumer is responding to The Home Depot value proposition. So we have innovative product. We have exclusive product. We have new technology and exclusive launches at The Home Depot. And we've worked very hard on our in-store selling model and Ann and her team are just doing a great job communicating that value to the customer in both our hard and soft flooring, and they're both doing extremely well, as I called out, double-digit comps for the category.

<Q - Kate McShane>: I was curious about your comment with regard to the reemergence of the first-time homebuyers. Is this the first time you're seeing this? And if this were emerging, would this be enough to offset any slowing of price appreciation if there were to occur?

<A - Carol B. Tomé>: Well, it's really interesting to see what happens with the first-time homebuyers in Q2. The highest number of first-time homebuyers since 2005, about 424,000 first-time homebuyers making up 38% of all homebuyers and up 11% year on year. So that's good news. Why? Because first-time homebuyers tend to buy homes that need repair and remodel. So as we see and we anticipated this happening, with millennials coming into of age where they start to form families, children, or pets, or whatever their family unit might look like, they're moving into homes which bodes very well for us, and to your point, it extends the recovery.

<Q - Kate McShane>: That's great. Thank you. And then, Ted had mentioned that the three events you conducted during the quarter. Just wondered if that differed in any way vs. last year and does that help explain some the acceleration into July?

<A - Edward P. Decker>: They were similar events in duration as last year, Kate.

<Q - Matthew J. Fassler>: My question relates to your discussion of sales trends by ticket. Can you just remind us whether that's store-only or whether that's inclusive of online? And then, I have a quick follow-up.

<A - Craig A. Menear>: Yeah, it's all in.

<A - Carol B. Tomé>: It's all in.

<Q - Matthew J. Fassler>: I guess, is there anything about the way consumers are shopping based on project or basket that would change the composition of that sales performance by ticket, just thinking about the outsized – extended outsized growth of the big ticket piece and the fact that the smaller ticket piece has been growing at a slower rate for kind of equally consistent period of time?

<A - Craig A. Menear>: The biggest driver behind that has been the recovery of our Pro customer and the growth that we've had in categories like appliances and flooring. Those are big ticket purchases in and of themselves. So appliances is clearly much larger than our average ticket. A flooring job is significantly larger than our average ticket. And our Pro customer spends dramatically more than the average DIY customer.

So, those have clearly helped to drive the growth in tickets above $900. And then we did see the recovery in the smaller ticket, Matt, as a result of the garden business coming back to a more normal state in Q2.

<Q - Dennis Patrick McGill>: One more question just going back to appliances online, I think you said 6% of sales are online now for the total store. Can you just maybe frame appliances relative to that number and just give a little bit more detail on how you mentioned, Craig, the buying experience in some cases starting digitally and ending digitally. What percentage of those big ticket transactions in appliances are executed online? Just to kind of give some frame a reference to the categories as a whole already being an online category.

<A - Craig A. Menear>: We don't break that data out. For competitive reasons, we would not share that data. Thanks.

<Q - Dennis Patrick McGill>: Okay. I won't count that as my question then. So my first question is – we'll shift to not online. When you look at outdoor garden, I guess, for H1 it's a below-average category. So I guess with the weather comps year to year, it didn't really get the typical bathtub effect. Carol, when you look at the back half of the year, do you expect that some of that could come back? And the full year would balance out? Or is that lost demand at this point?

<A - Carol B. Tomé>: Some of the softness is relative because the category grew, soils and mulch. And Ted, I wouldn't think we'd get much of that back.

<A - Edward P. Decker>: No. I think some of the uptick we saw in July was that extended season. All in, it was a reasonably good season. I wouldn't say great, certainly colder and wetter early, and it was really wet into June. So some late garden, but I think we've seen that, and it just isn't that big until you get into fall. And then hopefully you'll get a seed season and some planting season.

<Q - Dennis Patrick McGill>: Okay. And then second question, just as it relates to inventory, Carol. How would you characterize inventory in the channel today when you adjust for same-store and the acquisitions and so worth as far as what a supplier might be facing with projects and so forth? Is there less inventory throughout the channel today? And if so, can you quantify that in any way?

<A - Carol B. Tomé>: We're growing inventory to support our self. We also want to drive productivity, as Craig called out in his remarks, and so we're always going to look to improve the velocity of our inventory turn. But my goodness gracious, as Craig always says, customer service starts with in stock. You've got to have what the customers want, and certainly we will do that working with our supplier partners.

<Q - Dennis Patrick McGill>: So the inventory turns that you had framed earlier being up little bit, is that a same-store representation?

<A - Carol B. Tomé>: That is a one Home Depot representation. It includes inventory in our stores and in our distribution centers.

<A - Craig A. Menear>: Yes. I mean total inventory is up $545mm in the quarter.

<Q - Alan Rifkin>: Carol, you mentioned that the expense factor in H2 should be lower than in H1. Given the fact that typically H2 revenues in aggregate are less than H1. And you said that you forecasted comps to be a little bit lower in H2 vs. H1, is the reason for a lower expense factor in H2 entirely due to Compact Power? Or are there other things going on there?

<A - Carol B. Tomé>: Let me give you little bit more color on our expenses, if I could, please. As you know, we stepped up our capital spending program this year, taking our total spending up to $2B including $350mm of capital to invest in our stores. And certain of our stores are getting new wayfinding packages, new flooring, new lighting, new restrooms, new break rooms, so on and so forth. That capital comes with an expense.

Now, we didn't plan for the activity over every quarter. And in fact, a lot of that activity took place in Q2. And so if I look at our expense performance in Q2, while it was planned, expenses related to our store investment, which would include, old write-offs of old fixtures and reset expense and that sort of thing, year-on-year it was up $19mm. So it was pretty lumpy in Q2. That won't be as lumpy in the back half of the year, and that's really the driver of the expense growth factor H1 vs. H2.

<Q - Alan Rifkin>: Okay. Thank you very much. I appreciate that. And as a follow up, with respect to Compact Power, either Craig or Carol, could you maybe just talk about the margin structure for that business? Would it be correct to assume that it's a lower gross margin as well as lower SG&A business? And what effect on a full-time basis to EBIT margins does the acquisition of Compact Power in and of itself have?

<A - Carol B. Tomé>: Yeah. Happy to talk about it. First, to Compact Power. The revenues for Compact Power are recognized on a net and not a gross basis, so you have gross margin associated with that business. It's highly margin accretive, and Alan, that's one reason why our gross margin guidance for the year has changed from what has been down 15BPS to now down 10BPS.

Because if the revenues are recognized on a net basis and because there are expenses in Compact Power, it put some pressure on our expense growth factor for the year. We had guided that expenses would grow at 43% of our sales growth. We're now suggesting 46% of our sales growth. That's because there are no revenues, we record on a net basis, but there are expenses. As you look at the EBIT of Compact Power, it's very accretive. In the back half of the year, this is a small business, strategically very important. But in the back of the year, Compact Power shifts contribute $0.01 of EPS accretion.

<Q - Scot Ciccarelli>: Carol, you've already highlighted how the housing stock in the U.S. continues to age, and obviously that's been a pretty big theme for you over the last call it two years or so. Do you happen to – I know it's something you guys have been looking at for a while. Do you happen to have any analytics around the home improvement spending, maybe by vintage, or do you know if there's an average percentage spend relative to an average home price?

<A - Carol B. Tomé>: Yeah. A couple of data points. Homes built before 1980, the average annual home improvement spend is $3,500 a year. Homes built after 2000, the average annual home improvement spend is $1,500 a year. So there's a pretty nice delta as the homes age.

The other interesting data point, and we haven't proven this analytically in our own research, but I'll share it with you anyway, because I think it's very interesting. We look at John Burns Real Estate Consulting Group a lot, they've got some really interesting data in housing. And they say that for every percentage point of improvement in real wages, and real wages are up this year after inflation of 2.2%. They say for every percentage point increase there's a 1% increase in the repair and remodel spend. Interesting. We haven't proven that, but it stands to reason. If you got more money in your pocket, you're going to spend some more money on your home.

<Q - Scot Ciccarelli>: Yes, that makes a ton of sense. And then just a quick follow up. You also mentioned how first time home buying is finally starting to accelerate. And again, that should be good for duration, but just based on historical purchase patterns, would you expect that to impact your small ticket performance? Presumably there is a little – a lot more kind of nickel-and-dime type projects that are probably done, but I don't know if that's true or not?

<A - Carol B. Tomé>: We don't think so, no. Because when they're going into the homes, they need to repaint them, and paint is not just a bucket – a gallon of paint. But it's the tape and tarps and all the other stuff that goes with it, or re-floor.

<A - Edward P. Decker>: Yeah. I wouldn't think so, other than a trip for picture hanging or something like that would be under $50. But, yeah, your – which we like.

<A - Carol B. Tomé>: Which we like.

<A - Edward P. Decker>: It's older basket.

<Q - Scot Ciccarelli>: Right. So no real change in the cadence between big ticket and small ticket as you wind up getting more first time home buying?

<A - Carol B. Tomé>: We don't think so.

<Q - Keith Hughes>: You mentioned several times earlier in the call that your Pro is up well in excess of the DIY. Can you give us any insight on product categories that did particularly well with the Pro in the quarter?

<A - Edward P. Decker>: Well, certainly our building material categories did very well. Our electrical did very well. Tools, consumers, consumers love our power tools, but the Pros are really the heavy users of that. Lumber is very strong, lumber prices are near or at all-time highs per unit productivity is – the commodity price as we know, will go up and down, and we watch the units very carefully in lumber and building materials. And those have been very strong as well.

<Q - Keith Hughes>: You had mentioned earlier on the call in the introduction about new Pro paint initiative. Is that an area? Does that rank among your tops in terms of growth with the Pro?

<A - Edward P. Decker>: Yeah. The Pro paint initiative that we have with each of BEHR and PPG has been very successful. I'd say overall, we are pleased with our growth in our paint business. I'd say we're holding share, if not gaining a little bit of share in paint. But our Pro paint initiative in particular is multiples higher growth than our DIY paint business.

<Q - Scott A. Mushkin>: So I guess I wanted to take a step back and ask a broader question. A lot has been asked on the call. I mean, as you guys look at your business, because obviously just performing terrifically, and obviously a big tailwind from what's going on in macro, but also the great things you guys are doing. What do you worry about?

<A - Craig A. Menear>: So, I'd say there's two things that are up there on the list. And one is we're investing in the one Home Depot Experience. That's how the customer views us. Not exactly how we are built, so we have to do some things to get there completely. And you worry about the ability to execute on that fast enough and the change management that comes along with that.

Second worry, I'd say is the customer and the associate experience in our high-volume stores. Clearly, with the growth that we've had, that puts pressure on in those stores disproportionately. And so, we're going to have to invest to solve that situation, and we're working to put that in place, but those are certainly two worries that we have in the business.

<Q - Scott A. Mushkin>: All right. That's really good insight. But I was just wondering if you could talk about kind of how things are going so far this quarter. I mean, we have the retail sales numbers out today. They were good. And we've experienced sometimes a third quarter low because DIY is not as strong as Pro. I was just wondering any thoughts as we look into third quarter and anything we should consider.

<A - Carol B. Tomé>: Yes. Scott, as we mentioned just a little bit earlier, we are quite pleased with our sales in August thus far.

<Q - Matthew McClintock>: It's been a little over a quarter since you've now had access to Interline inventory and your stores. And I was wondering, conceptually, how should we think about the benefit from that access, building and having an impact on your sales? How do you build awareness of that? Is that really what we're waiting on to see an acceleration in the business from that, or – just how to think about that benefit layering in over the coming years? Thanks.

<A - Craig A. Menear>: I mean, I'll start and Bill is here, who runs our Pro and Services business. But as I call out my comments, we're actually very pleased with the use case one and use case two response from our customers. And with that, as well as the effort of the team at Interline, Interline actually grew above the company average growth in the quarter. So...

<A - Bill Lennie>: Yes. Just, Craig, thanks, a quick comment. We're not live in 1,958 stores, so we basically have finished the rollout. We have 1,500 stores that have access to Interline's products next day, and an additional 458 stores that are a two-day delivery. And we're seeing great activity on a broad base of goods, primarily servicing the trades from plumbing, electrical, hardware, also strength in the HVAC business. So it's doing a nice job of extending our product reach, giving us access to deeper inventories for Pros that are coming in and looking for project-based purchases. And then, overall, average ticket on par, ramping up sequentially week-over-week, I'm pleased with the progress in the MRO business.

<Q - Matthew McClintock>: And then, Carol, if I could have a follow-up, and I'm sorry if I missed this, but the 7BPS of pressure from higher shrink. I have to ask about it because it almost offset the benefit from the supply chain. Could you just talk about what you're seeing there, what's driving that? Thanks.

<A - Carol B. Tomé>: Yes. As you know, there are many drivers of shrink, including higher staff and changes in operational processes, and new systems. We have a cross-functional team that is addressing this. We're hearing from other retailers that best is up across the board, but we're really focused on, well, what have we changed inside of our store that perhaps caused some of this. And in fact, the cross-functional team has identified a few defects that we are correcting and we will continue to work on this going forward.

<Q - Peter S. Benedict>: First was just on kind of labor market and wages and availability of workers. I mean, what are you guys seeing on that front, whether it be with the seasonal folks that you hire or some of the specialty or full-time folks? That's my first question.

<A - Craig A. Menear>: Sure. So, Peter, we hired seasonally this year over 90,000 people, and one of the great things that happened in this season was we enhanced our application process through an improved mobile experience. It actually doubled our applicant pool, so we're very pleased with that. It was a better experience for the applicants themselves and was pretty effective on our end as well.

We are certainly seeing wage pressure and that varies market by market, but that's something that we anticipated and planned for. And it's actually built into our guidance for 2017.

<Q - Peter S. Benedict>: Okay. Thank you. And then, Carol, just curious on the FX, just to make sure we understood you correctly. Your guidance right now still assumes – I think it was $250mm headwind from FX for the year. Is that right?

<A - Carol B. Tomé>: Well, in the back half, it's actually $250mm. That's right. So if you were to add that back, you would calculate the comp to be about the same as what we reported in H1.

<Q - Peter S. Benedict>: Okay. And then last one, if I could just sneak one in. The store refreshes that you alluded to, remind us how many you are getting done this year. How many you think you could maybe do in 2018? And, Craig, anything specific? I mean, you talked about trying to alleviate some of the customer experience and associates experience friction that may occur in these high-volume stores. Anything in particular that you're focused on that you're seeing some improvement from as you work to reengineer the stores a little bit. Thank you.

<A - Craig A. Menear>: Sure. The first part of the question in terms of how many this year, approximately 500 stores will get the updates that Carol referenced earlier as it relates to the signage, navigational signage, lighting, floor, break rooms, restroom and so on.

And then in the high-volume stores, we have to work to continue to improve to experience for the customer on the front end in particular and get the customer through the registers with greater speed. And then likewise, those stores feel more pressure from BOPUIS and BOSS pickup, and we're working to solve that for them as well. And that will be a different scenario by different type of stores, but those of the areas of focus.

<A - Carol B. Tomé>: And, Peter, we've got an investor conference in December, and so we'll lay out our plans for 2018 and beyond at that conference.

<Q - Seth M. Basham>: As we look at the trends in small ticket sales relative to big ticket sales, obviously they've been underperformed for some time. Do you think that you're still gaining market share in some of the small ticket categories?

<A - Edward P. Decker>: Yeah. I would. The small ticket is healthy. We talked about the transactions being up 1.5%, but that also comes with a strong positive comp associated with those transactions. And the mix of the business, we used to talk about under $50 being 20-odd percent and over $900 being 20-odd percent, and that dynamic shifted as the customer has responded, we think largely, to the product and the innovation in the store.

And again, we look at this every single week. Where are the sales coming from in the assortment? And we continue to see the customer respond to the innovation and buy up the continuum on the assortment. An example of that would be in soils and mulch this year. So we talked about Garden coming later, which it did, and we had a fine garden business in Q2. But we were a little less promotional on commodity mulch because what we find is the customer is buying heavily into the organics. We have a number of exclusives in organics with Kellogg's and DR. EARTH's and some of the Scotts Miracle-Gro product, and customers are happily trading up. And we're talking two and sometimes three and four times the cost for a bag of organic mulch over commodity mulch.

So we look at it very carefully because it's a natural and fair question, but we continue to be comfortable with what the dynamic is of the ticket growth. We look again that it's exclusively this year product mix and then the effect of commodity prices, lumber and building materials. There has been no price impact on our AUR.

<Q - Seth M. Basham>: That's helpful. And given that it's been a theme of this call, as we think about the e-commerce impact on some of these smaller ticket categories, do you feel like you guys are better or less well positioned to gain share in some of these smaller ticket categories as a result of what's happening with the online channel?

<A - Craig A. Menear>: We feel very comfortable that we compete across all segments of the line structure. Opening price point, mid-price point, upper price point across channels.