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Company Name: Home Depot
Company Ticker: HD US
Date: 2018-02-20
Event Description: Q4 2017 Earnings Call

Market Cap: 218,030.34
Current PX: 186.71
YTD Change($): -2.82
YTD Change(%): -1.488

Bloomberg Estimates - EPS
Current Quarter: 2.129
Current Year: 9.559
Bloomberg Estimates - Sales
Current Quarter: 25269.773
Current Year: 107248.133

Q4 2017 Earnings Call

Company Participants

- Diane Dayhoff
- Craig A. Menear
- Edward P. Decker
- Carol B. Tomé
- Mark Holifield
- Kevin Hofmann

Other Participants

- Simeon Ari Gutman
- Brian Nagel
- Mike Baker
- Michael Louis Lasser
- Seth I. Sigman
- Matthew J. Fassler
- Chuck Grom
- Elizabeth L. Suzuki
- Dennis Patrick McGill
- Scot Ciccarelli
- Alan Rifkin
- Christopher Horvers
- Eric Bosshard
- Daniel Thomas Binder

MANAGEMENT DISCUSSION SECTION

Diane Dayhoff

Non-GAAP Financial Measures

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

Reconciliation of these measures is provided on our website

Craig A. Menear

Q4 Highlights

Opening Remarks

- Before I start, I'd like to recognize Diane Dayhoff
- This is Diane's last earnings call

- And I want to thank Diane for all her amazing contributions to the company in her nearly 15 years
- And so, Diane, we wish you all the best in retirement

Diane Dayhoff

Thank you

Craig A. Menear

Business Highlights

Sales and Diluted EPS

- FY2017 was another record year for our business, and we achieved the highest sales and net earnings in company history
- FY2017 sales grew $6.3B to $100.9B and an increase of 6.7% from FY2016, while diluted EPS grew 13% to $7.29
- Sales for Q4 were $23.9B, up 7.5% from last year
- Comp sales were also up 7.5% from last year and our U.S. stores had a positive comp of 7.2%
- Diluted EPS were $1.52 in Q4
  - We continue to see broad-based growth across the stores and our geographies
- All three of our U.S. divisions posted positive comps in Q4, but we did see more variability in regional performance than we have in several quarters due to weather

Mexico and Canada

- Internationally, both Mexico and Canada posted another quarter of positive comps in local currency
- While sales did benefit from hurricane recovery efforts, we also had hurricane-related expenses
- Our merchants, store teams, supplier partners and supply chain teams did an outstanding job delivering value and service to our customers throughout the quarter, both in stores and online

Pros

- As Ted will detail, both ticket and transactions grew in the quarter, and we saw growth in both Pro and DIY categories
- Pro sales once again outpaced DIY sales in the quarter, as the work that we're doing to enhance service capabilities for our Pros continue to resonate
- We were pleased with the growth of sales to our DIY customers who also gave us a likelihood to shop again score of 86%, up almost 150BPS from last year

Interconnected Business

- Our interconnected business made great strides in 2017, as the team continued to enhance our digital assets to enable a more seamless experience for our customers no matter how they choose to shop with us
- We implemented a new e-commerce platform, enhanced our search and mobile functionality, increased checkout speed and expanded chat functionality to improve the customer experience with our online contact centers

Online Sales

- We continue to invest in our digital properties and it has increased traffic and conversion. vs. prior year, our online sales grew 21% in Q4 and 21.5% in FY2017, now representing 6.7% of our total sales
- But we're seeing significant growth on our online sales
- These online shoppers see the relevance of our stores, as approximately 46% of our online U.S. orders are picked up in our stores, a testament to the power of our interconnected retail strategy

Upstream Supply Chain Network

- We have talked a lot about the progress we have made in building our upstream supply chain network over the past several years
- We've also told you about the $1.2B investment we plan to make over the next five years to leverage the capabilities and competitive advantages that we have in our upstream network while significantly improving our downstream proficiencies to leverage our scale in convenient locations
  - This year, we will pilot the local flatbed DFCs and market delivery operations
- But I want to remind you that this investment in One Home Depot supply chain is a five-year journey where the financial benefits won't be realized until the initiative is complete
- These investments are critical to meet the evolving needs of our customers, and we are committed to creating the fastest, most efficient delivery network for home improvement products

Accomplishments

- But we are not an organization that rests on our laurels of previous accomplishments
- I don't want to miss this opportunity to applaud each and every one of our associates for the incredible work that has brought us to this point in our company's history
- As I mentioned, FY2017 was a record sales and earnings year on the heels of a record FY2016

Retail Environment

- In 2017, our associates and suppliers served our customers during their time of need as we navigated the disruptions caused by various natural disasters
- We also welcomed two new teams to The Home Depot family through the acquisitions of Compact Power and The Company Store
- All of this was accomplished during a time marked by high degree of change in our business as we respond to the rapidly evolving retail environment
- As they always do, our associates continued to adapt to these changes while consistently delivering outstanding customer service

- Today, our board announced a 15.7% increase in our quarterly dividend to $1.03 per share
  - We remain committed to maintaining disciplined capital allocation to create value for our shareholders

Sales and Diluted EPS

- Turning to 2018 and beyond, I'm very excited about the opportunities that are ahead of us
- Carol will take you through the details, but we expect 2018 to be another year of growth, with expected sales growth of approximately 6.5% and diluted EPS of approximately $9.31

Investment Strategy

- At our Investor Conference in December, we outlined our three-year financial targets and an accelerated investment plan to create the One Home Depot experience for our customers
- Today, we are reaffirming our investment strategy and our 2020 targets to grow sales as high as $120B with operating margin as high as 15%, and we are updating our return on invested capital target to now more than 40%

Success Sharing

- One of the areas that we're investing in is our associates
- And in Q4, we did just that
- We recognize associates through Success Sharing, our profit-sharing program for our hourly associates
- For H2, 99% of our stores qualified for Success Sharing
- Beyond Success Sharing, we were pleased to be able to pay out an incremental one-time bonus to our hourly associates in light of tax reform

Summary

Together, this was an investment in our associates of more than $240mm in the back half of the year

I want to close by thanking all of our associates for their hard work and dedication to our customers in Q4 and throughout the year

- We look forward to continuing this momentum in 2018

Edward P. Decker

Q4 Highlights

Performance

- We had a strong fourth quarter, as sales exceeded our expectations
- We saw strength across the store led by our Pro customer, and our online sales continued their double-digit growth
- Looking at our departments, lumber, electrical and tools had double-digit comps in the quarter

  - Appliances, plumbing and building materials were also above the company's average comp
- Decor, flooring, millwork, paint, indoor garden, hardware, outdoor garden and kitchen and bath were positive, but below the company average
- Lighting recorded a low-single digit negative comp, primarily due to LED price deflation

Ticket and Transaction

- In Q4, we saw growth in both ticket and transactions
- Comp average ticket increased 5.5% and comp transactions increased 1.9%
- Commodity price inflation in lumber, building materials and copper positively impacted average ticket growth by approximately 105BPS

Foreign Exchange Rate

- Foreign exchange rates also positively impacted average ticket growth by approximately 42BPS
- Big ticket sales in Q4 or transactions over $900, which represent approximately 22% of our U.S. sales, were up 9.8%
- The increase in big ticket sales was driven in part by strength in vinyl plank flooring, fencing and appliances
- Transactions for tickets under $50, which make up approximately 16% of our U.S. sales, grew by 0.8% in the quarter

Sales

- In Q4, we saw strong sales with both our DIY and Pro customers
- Sales to our Professional customers were double digits in the quarter
- Pro-heavy categories, such as a lumber, pressure-treated decking, insulation and gypsum, all had double-digit growth during the quarter with solid unit productivity
- Our paint initiatives continue to gain traction, as we saw strong sales to both our Pro and DIY customers throughout the quarter

DIY Customers

- Turning to our DIY customers, we saw a terrific response to our events throughout the quarter
- Traffic was strong both in-store and online during our Black Friday, gift center and holiday events
- During the quarter, our DIY customers drove strong comps in power tools, hand tools, rugs, appliances and decorative holiday
  - We also continued to see strength in storm-related categories in the quarter with double-digit comps in generators, wet/dry vacs and portable heating

Artscape

- As part of our focus on balancing the art and science of retail, we continued to refine and localize our assortments

- A recent example is with our Artscape category, which includes pavers, wall block and landscape rock
  - We are leveraging the power of our clustering and space optimization tools to assign assortments and facings at a local store level
- As a result, we have been able to optimize on-shelf inventory levels to provide job lot quantities for our customers, minimize shelf maintenance for our store associates and maintain a meaningful and innovative assortment
- Initial results in warm weather markets have been strong

Product Innovation

- Now, let me turn our attention to Q1
- Product innovation and speed to market allow The Home Depot to maintain its position as the number one retailer in product authority in home improvement
- To that end, our merchants are constantly collaborating with our suppliers to deliver new products exclusively to The Home Depot
- For example, we have recently updated our assortment of client tools for professional electricians
  - This includes the new 9-inch Journeymen diagonal cutting pliers that provide 57% more cutting surface and a new magnetizer tool that is great when needing to magnetize a screwdriver or a bit
- The addition of these new products to our existing assortment of big-box exclusive client tools keeps us winning with the electrician

Spring Black Friday Event

- With spring quickly approaching, we are gearing up to fulfill the needs of our customers as they complete their outdoor projects and get ready to enjoy the warm weather
- In addition to our annual Spring Black Friday event, we are excited about our new patio set offerings, which provide customers great value across a wide selection to fit their specific style and needs
- New this year, as part of our exclusive Hampton Bay collection, we are offering Cushion Guard technology, which guarantees water repellency as well as protection from fading and stains
  - This gives our customers peace of mind and reassurance that they are purchasing quality material at an everyday low price

Carol B. Tomé

Financial Highlights

Sales

- In Q4, total sales were $23.9B, an increase of 7.5%. vs. last year, a weaker U.S. dollar positively impacted total sales growth by approximately $100mm or 0.5%
- Additionally, we estimate that hurricane-related sales positively impacted total company sales growth in the quarter by 1.7% or $380mm

Same-Store Sales

- Our total company comps or same-store sales were positive 7.5% for the quarter, with positive comps of 8.3% in November, 11.5% in December and 3.1% in January
- Comps for U.S. stores were positive 7.2% for the quarter, with positive comps of 8.2% in November, 11. 4% in December and 2.5% in January
- Our monthly comps were distorted by the timing of Christmas
  - This year, the Christmas holiday fell in our fiscal January rather than December
- Adjusting for this timing shift, our total company comps would have been 8.3% in November, 8.5% in December and 5.8% in January
- For FY2017, our sales increased 6.7% to $100.9B and total company comps sales were positive 6.8%
  - Comps for U.S. stores were positive 6.9%
- During the year, foreign exchange rates positively impacted total sales growth by approximately $67mm or 0.1%

Gross Margin

- In Q4, our gross margin was 33.9%, a decline of 12BPS from last year
- We attribute the modest decline in our gross margin primarily to lower margin hurricane-related sales
- For the year, we experienced 11BPS of gross margin contraction, in line with our plan

Operating Expense

- In Q4, operating expense, as a percent of sales, decreased by 30BPS to 20.5%
- Our expense leverage was driven primarily by our strong sales performance
- During the quarter, we had a few expenses that we did not plan
- First, as a result of the one-time cash bonus stemming from tax reform, we incurred approximately $117mm of incremental expense, and we incurred approximately $66mm of hurricane-related expenses

Operating Margin

- FY2017 operating expense, as a percent of sales, was 19.5%, a decrease of 47BPS from last year
- For the year, our expenses grew at approximately 63% of our sales growth rate
- Ignoring hurricane-related sales and expenses and backing out the one-time bonus, our expenses grew at approximately 45% of our sales growth rate in FY2017
- Our operating margin for Q4 was 13.4% and for the year was 14.6%

Interest and Other Expense

- Interest and other expense for Q4 grew by $11mm to $246mm, reflecting for the most part a higher long-term debt balance vs. last year

- In Q4, our effective tax rate was 39.6% compared to 35.2% in Q4 FY2016
- In Q4, we recorded a net tax expense of approximately $127mm resulting from tax reform
    - While this is a provisional charge, it was slightly better than our initial estimate

Diluted EPS

- Our diluted EPS for Q4 were $1.52, an increase of 5.6% from last year
- For the year, diluted EPS was $7.29, an increase of 13% compare to FY2016
- Our fourth quarter and FY2017 diluted EPS were negatively impacted by approximately $0.17 due to the one-time bonus and net tax expense previously mentioned

New Store Openings

- Now, moving on to some additional highlights, during the FY, we opened six new stores, including three in the U.S. and three in Mexico, for an ending store count of 2,284
- Selling square footage at the end of the year was 237mm square feet
- For the FY, total sales per square foot increased 6.7% to $417, the highest level since FY1999
- At the end of the quarter, merchandise inventories were $12.7B, up $199mm from last year
- Inventory turns were 5.1 times, up from 4.9 times last year

Capital Allocation

- Moving on to capital allocation, in FY2017, we generated approximately $12.3B of cash from the business and used that cash as well as proceeds from $3.3B of both short and long-term debt issuances to invest in the business, repurchase our shares and pay dividends to our shareholders

CapEx and Acquisition

- During the year, we invested approximately $2.3B back into the business through CapExs and acquisitions
- Further, we repurchased approximately $8B or about 49.5mm of our outstanding shares, including roughly $2.1B or 11.5mm shares in Q4

Dividend

- Finally, during the year, we paid $4.2B in dividend
- Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 34.2%, 280BPS higher than the end of FY2016

Guidance

Revenue Recognition

- Today's press release includes our guidance for FY2018, and I want to take a few moments to comment on the highlights
- Remember that we guide off of GAAP, so FY2018 guidance will launch from our reported results for FY2017
- There are a few things to keep in mind when thinking about our FY2018
- First, FY2018 will include a 53rd week, so Q4 FY2018 will consist of 14 weeks
    - We will continue to report comps on a 52-week basis, but we will base our overall guidance on 53 weeks
- Second, beginning in Q1 FY2018, we will adopt ASU 2014-09, which addresses revenue recognition
- This accounting standard will not have a material impact on our sales or our operating margin guidance, but it will change the geography of certain items on our income statements
- Our guidance today does not incorporate this new standard
    - We will give you a more detailed update during our first quarter conference call in May

U.S. Economy

- Finally, our guidance incorporates the investment plans we laid out in December and the impact of tax reform
- So with that, let's zoom out and look at the macro environment
- The U.S. economy is strong and tax reform is net positive for the housing industry

Income Growth

- We expect higher job growth, higher income growth and, yes, higher mortgage rates
- But with that comes higher home price appreciation and rising housing demand, which should drive home improvement spending
- For FY2018, we expect sales to grow approximately 6.5% with the extra week adding approximately $1.6B in sales

Comp Sales and Gross Margin Rate

- During FY2018, we expect total company comp sales of approximately 5% and we're planning to open three new stores
- For FY2018, we are projecting our gross margin rate to be about the same as it was in FY2017, reflecting for the most part the benefit of the extra week

Tax Reform

- As we discussed during our December Investor Conference, we have a number of investments planned which will cause our expense growth factor to be higher than what it's been in the past
- Further, with tax reform, we have elected to pull some of the investments forward into FY2018

Operating Expenses

- We expect our 2018 operating expenses to grow a little more than 100% of our sales growth rate

- For the year, we expect that our operating margin will be approximately 14.5%, with the extra week adding approximately $300mm in operating profit

Tax Rate

- For FY2018, incorporating tax reform, we estimate our effective tax rate to be approximately 26%
- We expect FY2018 diluted EPS to grow approximately 28% to $9.31, with the 53rd week contributing approximately $0.19
- Our EPS guidance includes our plan to repurchase approximately $4B of outstanding shares during the year

Cash Flow

- For the year, we project cash flow from the business of roughly $14.1B, which includes about $1.8B of cash resulting from tax reform
- We will invest $2.5B of this cash back into the business in support of the strategic initiatives we outlined at our Investor Conference

Dividend and Share Outstanding

- We will also use this cash to pay $4.8B of dividends
- As Craig mentioned, we just announced a 15.7% increase in our quarterly dividend, which equates to an annual dividend of $4.12, in line with our targeted dividend payout ratio of 55% of earnings
- Finally, we will repurchase $4B of outstanding shares
- Note that this is a preliminary share repurchase target, and may be adjusted throughout the year
- At our Investor Conference in December, we shared with you our long-term financial targets and our strategy to create One Home Depot
- Over the next three years, we will nearly double our investments into the business to enhance the customer experience, invest for the future and create value

Long-Term Targets

- Today, we are reaffirming and updating our long-term targets
- By FY2020, we are aiming to grow our sales to a range of $115B to $120B, with an operating margin of 14.4% to 15%
- Reflecting the impact of tax reform and a resulting higher net operating profit after-tax, we now believe our return on invested capital in FY2020 will be more than 40%

QUESTION AND ANSWER SECTION

<Q - Simeon Ari Gutman>: My first question is on the top line in Q4. You were cycling two warm winters, and I realize the hurricane was some benefit in the quarter. But if you look at the underlying run rate of the business, is there anything to glean, like did the business – the fact that some of these categories were still hanging in despite you've had more normalized weather, does that mean we should see an even stronger spring when we get there?

<A - Craig A. Menear>: I think, overall – we were, first of all, very pleased with the performance in the quarter both across categories as well as geographies, to your point. We definitely had benefit from hurricane recovery sales, partially offset by actually a real winter in January this year.

But, Carol, you might want to share just how we made up Q4.

<A - Carol B. Tomé>: Yeah. So, we were really pleased with the results in Q4. Clearly, the hurricane sales were higher than what we had included in our guidance at the end of Q3. So we were pleased with that. But the business – just the underlying business was very strong. As Craig pointed out, we had winter. And if you look at the month of January alone and the comps across our divisions, the comp in the Western division and the Southern division in the month of January was higher than the comp for the company for the quarter. Now in the North, where we had a real winter, and I think you experienced that winter, our comp was low-single digit, as you expected. So what does that mean? We should have a pretty good spring I would think when you have a normal winter.

<Q - Simeon Ari Gutman>: Okay. And then my second question, looking at the housing market in total and then maybe looking at the market color that you guys have, in more mature markets where the housing market has already recovered, can you talk about any trends, good or bad? And then, alternatively, in less mature recovery markets, anything that you're seeing that's encouraging about the pace of, I guess, the sales in those markets?

<A - Carol B. Tomé>: Yeah. So, as Craig mentioned, if you look at the variability in our regions, the spread was a bit wider than we've seen in the past several quarters, but that's because of the hurricane-related sales where we had high, high-double digit comps. But if you ignore the hurricane-related sales, you actually see the variability tightening. And that's actually because the economic environments in the cities that have recovered is robust, and there's a housing shortage.

So, let's take a look at San Francisco, for example. San Francisco is very robust. The month's supply in San Francisco [Technical Difficulty] (29:09). So we continued to see strong growth there. In areas of the countries that haven't fully recovered, well, good news there too. So housing as an asset class across the country continues to be very good.

<A - Craig A. Menear>: I'll make one other comment on that. If you look at a market like Dallas, which has had tremendous growth in home value appreciations, the Affordability Index is still terrific. So we're looking at housing continuing to be a tailwind for us.

<Q - Brian Nagel>: Congratulations, Diane. So I wanted to just follow-up quickly on Simeon's question on hurricane. So if we look at the cadence of the business over the last couple of quarters, it seems like you actually got a bigger benefit from the hurricanes here in Q4, which was a little surprising to us. Any new insights – and as you're watching these sales come through, as to how long these benefits could persist into 2018?

<A - Carol B. Tomé>: Yes?

<A - Craig A. Menear>: So, overall, Q4 was almost comparable to Q3 in terms of total benefit, which, as Carol mentioned, fourth quarter was slightly stronger than what we had anticipated. When we look at the go-forward in the business for 2018, we expect the sales from hurricanes to be somewhat comparable to what we experienced in 2017 overall, and most of that coming in H1.

<A - Carol B. Tomé>: Right. So just to put to the numbers behind that, we believe we had $652mm of hurricane-related sales in the back half of 2017, and we expect to have that same number of sales in 2018. The difference, of course, is that the 2018 sales will be a little bit more profitable than what we experienced in 2017. In fact, when you add it all up, we lost money on those sales. We lost about $11mm on those sales in 2017, and we expect to lose a little bit of money on those sales in 2018.

<Q - Brian Nagel>: Got it. And then my follow-up question. Carol, you mentioned in your prepared comments just the – I guess, a pull forward a bit and the cadence of investments that you laid out in the Analyst Day and how the tax legislation was just passed. Any more color on – specifically what investments you're pulling forward earlier? And then how should we think about with that – the potential return on those investments?

<A - Carol B. Tomé>: Yes, happy to. So let me just give you a breakdown of our expense growth factor guidance for 2018. Our core expenses will grow at about 45% of our sales growth next year. We add to that then about 10% related to acquisitions. Now, as we've talked in the past, our acquisitions have more variable expenses than our core. So when you add up core and acquisitions, expenses growing at 55% of our sales growth. Then, the investments that we're making add another 46-plus so that our expenses will be a little more than 100% of our sales growth in 2018.

What are we pulling forward? Well, if you remember the pie chart that we shared with you at our Investor Day, and we've showed buckets of expense, one of the buckets of expense was a bucket called Other, and in that bucket called Other were people expenses. So we are pulling forward some of those people expenses because those are easy things to do. Some of the other investments that we're making – it takes time. Well, like we talked to you about supply chain as an example, our supply chain initiative is actually a five-year initiative. But the people investments are things that we can pull forward, and we think that's the right thing to do.

<Q - Mike Baker>: Two questions: One, can you explain the calendar shift in a little bit more detail, December vs. January? How does Christmas end up in January? And then, I guess, related to that, even when you make that adjustment, January does seem to have been a little bit softer, but is that just the winter weather?

<A - Carol B. Tomé>: Yeah. So, Michael, it's – just our accounting convention. We have a [ph] four, four, five (33:43) close. And it's just when Christmas Day falls and Christmas this year was a Sunday or a Monday, anyway, it just fell into another month. So it's just calendar. That's all it is.

In terms of our January comp, yes, even on an adjusted basis, it was lower than the previous two months. But we had a winter in January, as I mentioned. Our Western division, our Southern division in the month of January comped higher than the company average for the quarter. Well, we can get a sense of where those comps were very good. But in the North, where we had winter, it was low-single digits.

<Q - Mike Baker>: Right, okay. Yeah, that makes sense. One follow-up. Rates, doesn't seem like it's an issue yet. But I think in the past, you've given some color on – where is that sort of bright point where we start to become worried about rates either measured on a 10-year bond or a 30-year fixed mortgage, however you look at it?

<A - Carol B. Tomé>: Yeah. So 30-year rates today are 4.2%. The consensus estimates for 2018 is 4.3%. I've seen a high estimate out there of 4.6%. But just to put it into perspective, our math suggests that for every 25BPS of a mortgage rate increase, it's $40 of additional mortgage interest per month. So we don't see any concern with a rising interest rate over the next several years actually. Remember that historical 30-year mortgage is 5.6%. And as Craig commented, the Affordability Index broadly speaking is still very good at over 155%.

<Q - Michael Louis Lasser>: As we look out over the course [Technical Difficulty] (35:38) should we expect to see the composition of your same-store sales change at all, particularly as you make more e-comm investments and your e-comm mix just comprises a bigger percentage of the total? Or as you've said in the past, should we expect half coming from ticket and half coming from traffic?

<A - Edward P. Decker>: Yeah. We still look at it on a split of roughly 50-50 over time coming from ticket and traffic overall.

<Q - Michael Louis Lasser>: It has...

<A - Edward P. Decker>: From departments, we still have opportunity in larger ticket, building materials, special order kitchens, lumber. While lumber has certainly run up in price, the project is simply still growing and we still have significant opportunities. So from a department perspective, we see more continued growth in those departments.

<Q - Michael Louis Lasser>: And, Ted, is there anything to read into about the performance of the lighting category? Price deflation in LED has been happening for a long time. Could it be now that, that category has just reached either a maturity point or it's now starting to shift more online?

<A - Edward P. Decker>: No, we see the price deflation continuing into 2018. And we plan for meaningful deflation to continue throughout 2018.

<A - Carol B. Tomé>: There's some good news with price deflation, though, because we are relamping our stores with LED lights. And it was a good thing that we waited for this investment because the cost curve is coming down. So [indiscernible] (37:18).

<A - Craig A. Menear>: That's true.

<Q - Seth I. Sigman>: And, of course, Diane, congrats. Hey, just wanted to follow-up on the gross margin outlook for flattish in 2018. I'm wondering if you can reconcile that with the longer-term guidance that calls for – I think it was a decline of 40BPS over the next three years. And related to that, presumably, freight and mix could still be headwinds as you look into 2018. What are you assuming as other offsets in there? Thank you.

<A - Carol B. Tomé>: Yes. So we've guided gross margin flattish for the year. That includes the 53rd week. The margin in that 53rd week will be higher because it doesn't have as much fixed cost allocated to it. So if you ignore the 53rd week, the gross margin for the business would be done, call it, 7-ish basis points.

We have factored into our outlook a tightening transportation market, higher fuel cost, although that's gotten better recently. We're going to have stay close to this. We've got lots of cost-out opportunities that we will certainly drive, but the transportation market is tightening. So, you might have a little pressure there, but we'll manage through it.

<Q - Seth I. Sigman>: Okay. And then a question on the delivery from store initiative, I think it's been in the stores for over a year now. Can you speak about the performance, the types of Pros that are utilizing it? And if you're seeing actually new customers come in or is it just driving share of the existing Pros' wallet? Thank you.

<A - Craig A. Menear>: Sure, Seth. I will comment. We are very pleased actually with the growth overall and delivery and we are seeing that happen both with our Pro and with our consumer. And Mark's here, I will let him comment.

<A - Mark Holifield>: Yeah. We are seeing the same kind of mix of Pro and consumer that we see across the business. We are very pleased that, that store-based delivery continues to grow. One highlight there, we're continuing to rollout the car and van lower-cost delivery options to more markets as we go, including our home market in Atlanta now. So expect to have that rolled by spring to all the major markets.

<A - Carol B. Tomé>: And the question always is incrementality, and based on our analysis, we're driving incremental growth here.

<Q - Matthew J. Fassler>: Diane, thanks so much for all your years. And Isabel, welcome back to you. Well, I want to start with a quick follow-up for Carol. You gave the adjusted comps on a monthly basis for the total company. Do you have December and January numbers for the U.S. stores alone?

<A - Carol B. Tomé>: It's a 300 basis point shift. So you can just do that math.

<Q - Matthew J. Fassler>: Great. My next question, if you talk about the transactions under $50, I mean, we're used to, at this point, to the bigger ticket transactions growing at or close to double digit and the smaller ticket transactions growing low singles. Are those transactions being subsumed by – in other visits, i.e., the visits are coming down and that's just reflected in bigger ticket? Is it a question of market share? Is it a question of that business being done online? How should we think about that trend in the small ticket business?

<A - Craig A. Menear>: Matt, we've actually done some work in this area. And I would start with a comment that this has been impacted by both innovation and inflation. And I will let Carol walk through the details of this, but we're actually pleased with what we're seeing.

<A - Carol B. Tomé>: We are. So, we took our ticket and broke it into quintiles. And if you look at the bottom quintile, we see the price has jumped through innovation and inflation 11% over the past couple of years. So it's moving out of that less than $50 bucket into a higher bucket. The other contributor is price deflation in LED light bulbs. LED light bulbs would be in that $50 bucket. So it's just a change in the business model, and we're reacting to that change.

<Q - Chuck Grom>: Just a quick modeling model. Just on the expense growth factor of slightly north of 100%, should we expect that to be pretty even throughout the year by quarter, or are you expecting any lumpiness throughout the year?

<A - Carol B. Tomé>: It will be lumpy. It will be higher in H1 than in the back half of the year because in the back half of the year of 2017, we had hurricane-related expenses that will not repeat.

<Q - Chuck Grom>: Okay, helpful. And then just historically, when you have the type of winter that you guys are going through this year and us as well, can you just remind us how the business tends to pick back up in the spring based on your historical experience?

<A - Craig A. Menear>: Well, it totally is dependent on when spring actually breaks. Yeah. And that can happen earlier, it can happen late. Mother Nature will control that. But what we do see from that type of activity is generally, you will see when you have a harsh winter, you've got a lot of garden opportunity with replacement of shrubs. You have ice damage that takes place on roofing. So there's different types of elements within the business that will actually see a benefit from a hard winter.

<Q - Elizabeth L. Suzuki>: Just generally, when costs are rising, transportation, labor, general inflation, et cetera, how much of these cost increases are you able to pass through to the consumer?

<A - Craig A. Menear>: Well, first of all, in each situation with cost in our first cost of goods, we look at that on a case-by-case basis and work with our suppliers to help them try to minimize as many impacts as we possibly can. And then, candidly, we look at our portfolio approach to how we actually deal with that. And so cost may not necessarily go into a category where we may absorb some costs, it could go somewhere else. And we, obviously, look to offset that within our own business to try to hold value for the customer.

<Q - Dennis Patrick McGill>: Carol, first question, from the Investor Day, I think you talked about the investments, hopefully adding somewhere in the neighborhood of – I think it was 50BPS to 200BPS to same-store sales growth. How did you think about the benefit in 2018 when you formed the plan?

<A - Carol B. Tomé>: Yeah. So not a lot of benefit in 2018 because we've got to first make the investments. And if you think about – we talked about $11.1B investment over the next three years, we're going to kind of ramp up. So you're going to see more of the return in the back half of the three-year planning than you do in the initial part of the three-year plan.

<Q - Dennis Patrick McGill>: Okay. Thank you. And then second question, when you talk about the cash flow from the business and then look at the guidance for share repurchases, can you just maybe talk about how you thought about getting to that $4B number, especially with repatriation being an opportunity? And maybe also just update us on where that stands as far as getting that cash back?

<A - Carol B. Tomé>: Yeah. So based on the cash flow guidance that we've given you and the use of cash, you're like, wow, you're going to have some leftover cash, and that's right, we are. And we are exploring what to do with that cash. And it could be additional share repurchases, dividends, pay back debt, build cash for the future, so on and so forth. We're going to take our time to think through this thoroughly and once we determine what we will do with the cash, we will let you know. The $4B specifically is what we had on our Investor Day. So we just kept that for the year and then we'll update you as the year continues.

<Q - Scot Ciccarelli>: Carol, I don't know if this was answered earlier. If you did, I apologize and I missed it. But what is the mortgage rate that you think starts to adversely impact home pricing trends? And then related to that, obviously, real estate is a very localized industry, but do you have thoughts regarding the potential impact on home prices [ph] in salt (46:33) affected areas?

<A - Carol B. Tomé>: Yeah. So let's look at the latter part of your question first. 80% of American households are going to have more money this year because of tax reform, given the increase in standard deduction. Further, corporations are enjoying – many corporations are enjoying lower taxes. And we see many corporations taking that cash, if you will, and investing it in the people [Technical Difficulty] (47:01). We think those two things by themselves offset any negative that could arise with the change in the mortgage interest deduction or the cap on state and local tax deduction. And just a few other things, on the cap on mortgage interest deduction, $750,000, only 5% of houses that are sold in a year are $750,000 or above. So it's a small subset of what happens in the housing market. Further, as we've talked about, only about 30% of tax filers itemize and only about 22% of them itemize for mortgage deduction.

On the state and local tax front, if you live in California or in New York, it's not going to feel very good. But then, there's a housing shortage. And I've commented on San Francisco with 0.8 months of supply. New York City has 2.2 months of supply. So we don't actually think there's going to be any impact on housing as a result, although, if you live in New York or California, you may feel it.

Yeah, on mortgage rates, can't just look at mortgage rates alone because you have to look at where home prices are going to look at affordability. But if you just kept home prices where they are today, it's our view that mortgage rates could go to 7% before there's any issue on the affordability end of that.

<Q - Scot Ciccarelli>: Got it.

<A - Carol B. Tomé>: The other way of looking at it is just averages, right? And the average mortgage rate over the past 30 years was 5.6%. So that might be a good number for us all to, kind of, to land on.

<Q - Alan Rifkin>: Congratulations, Diane, on your retirement and welcome back, Isabel. So shortly before the tax reform was passed, you laid out your three-year goals. And presumably, they're going to be incremental investment from the tax savings. Why is that? And obviously, that will result in increased returns. My question is, why is there no change to the three-year 2020 guidance if the returns by that point should be realized?

<A - Craig A. Menear>: So, Alan, we're actually not looking to do incremental investment beyond what we shared. The $11.1B over three years is what we believe that we need to do. And there's a kind of, if you will, a doability factor to making that all happen. So there is not really the opportunity to add a whole bunch of new investment on top. As Carol mentioned, we are pulling some investments forward that we can do and make it happen faster, but don't look for us to add a whole new layer of investment on top of the $11.1B.

<Q - Alan Rifkin>: Okay. Thank you, Craig. And a follow-up, if I may. I believe you said that the flooring category, while comping positive, was below the corporate average. It seems like, for the first time in many quarters, that is the case. So I was curious if you could provide some color as to what is going on in that category, in your opinion?

<A - Edward P. Decker>: We're very pleased with the performance. You have to remember, Alan, the average is 7.5%. So, it's very healthy across the flooring portfolio.

<Q - Christopher Horvers>: So, following up on the SG&A and sales growth rate. You guided over the three-year 75% to 90%. Is the pull forward mainly from 2019 into 2018? And how should we think about the cadence of that 75% to 90%, as we look past this year? Is 2019 thus lower as a result?

<A - Carol B. Tomé>: We pull forward both from 2019 and 2020. So, we'll update you on 2019 and 2020 guidance when we get to those two years. But nothing changes from the overall expense growth factor guidance that we gave you back in December.

<Q - Christopher Horvers>: Understood. And as you think about how robust the backdrop here as in home improvement, has there been any changes in terms of the promotional environment? Seems like some prices being passed through here. Is it becoming less promotional or any change at all sequentially?

<A - Craig A. Menear>: I don't think there has been a significant change in the promotional activity. If anything, we were less promotional in Q4. But the overall market was very similar to prior year.

<Q - Eric Bosshard>: In terms of Pro and online, I'm just curious what you learned or any big learnings from those two areas in 2017? And then how you think about the growth rate in 2018 relative to 2017 in those areas.

<A - Craig A. Menear>: So overall, we were very pleased with our Pro business in 2017 and we continue to see growth there. And as customers continue to take on bigger projects as a result of feeling good about their home values, we see that continuing as we move into 2018. I don't know if you have any other comments on that?

<A - Edward P. Decker>: Eric, I'd say the other learning is that, the more dimensional our relationship with our Pro is, the stronger our share wallet becomes. And I think that was exemplified by the Pros that are managed by our process, which was one of our fastest-growing areas for our Pro business. So, it's that Pro engagement and that one-on-one recognition that seems to be resonating with the customer, and we'll carry that into next year.

<A - Craig A. Menear>: And as it relates to online, again, very pleased with what the team was able to accomplish in our online business, setting in a whole new platform that we operate on, enhancing our capabilities around search and mobile. And Kevin is here, and I'll let him speak to how we're thinking about 2018.

<A - Kevin Hofmann>: Yeah. Certainly, from a learning perspective, it just reinforced what we've been chasing; chasing the customer, and where they lead us. We invested significantly to eliminate a lot of friction between the different channels as we pursue our One Home Depot strategy, investing in expertise, in knowledge and the online property. You'll see more of that in 2018 with similar growth aspirations. We've got a consistent track record of over $1B of growth in each of the last few years in our online property, and we'll look to do that again in 2018.

<Q - Eric Bosshard>: And then one follow-up question. The inventory progress – inventory leverage was solid in 2017. The two points within that, what contributed to that and how should we think about the path of that moving forward?

<A - Craig A. Menear>: Well, we were very pleased with our overall inventory position as we came through Q4 and finished the FY. Our primary focus when it comes to inventory is to maintain in-stock; that is first and foremost, so that we have what the customer needs on the shelf when they come in. And Mark, I don't know if you want to make any additional comments.

<A - Mark Holifield>: Right, Craig. I mean, customer service begins with in-stock. So that's always the top initiative, but we'd expect to continue to leverage inventory as our content business continues to grow in the quarter. We'll be making some investments as we open new distribution facilities for online, but we continue to expect to leverage our inventory.

<A - Carol B. Tomé>: Yeah. So if you just want to model it, model inventory turnaround 5.3 times.

<Q - Daniel Thomas Binder>: Just on the Pro. I was wondering if you talk a little bit about that gap between DIY and Pro. I know it's been consistently growing faster than DIY. Is that accelerating? And then could you also talk a little bit about the Interline trends?

<A - Edward P. Decker>: Well, Daniel, I think the one thing that we're seeing is, there is a little cloudiness in where the actual purchases are coming from. In some cases, they're seeing people that had DIY projects that are now electing their Pros to go and do both the purchase and the work. But we're very pleased with the DIY growth and seeing strength with our consumer business as well as the Pros. So there is a good balance there.

And then as far as the Interline, we're pleased with the progress, pleased with the results. We saw strong sales growth in all three end markets: institutional, multifamily and trades. Continue to see traction in the Pro purchase and the MRO initiatives. So, pleased with the progress.

<A - Carol B. Tomé>: And maybe one difference that we are seeing is the rate of growth for the high-spend Pro is the same as the rate of growth of the low spend Pro. [indiscernible] (56:43)

<Q - Daniel Thomas Binder>: And then one follow up, if I could, on merchandising. One of the emerging trends we've seen out there obviously is connected home. Just wondering when we'll see more from The Home Depot on that? It seems like you're pretty well positioned to capitalize on it, but maybe a little bit further behind some other players in the electronics space on that area of the business.

<A - Edward P. Decker>: Yes. We're rolling out some more dedicated end caps in one and two and even three base sets, as the amount of connected home product comes into the store. We're super excited. There is new product coming from Ring, there's new product coming from Nest. There is new product coming on light and fan controls by Lutron. So, really across the board all our major suppliers are coming up with great innovator product, and we're growing the space in the store to merchandise it appropriately.

<A - Craig A. Menear>: I think the other thing that you'll see is, just in general, in every bay in the store where there's an opportunity to have product that has enabled through technology, you'll see that happen over the next five years. It will continue to evolve. And it won't be so much a section over the next five years; it will be in every bay in the store. That will happen because the manufacturers are finding ways to enhance their product for the customers.